# OTHER PEOPLE'S MONEY: THE PROBLEM OF PROFESSIONAL FEES IN BANKRUPTCY

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Complaints about the allowance of professional fees in chapter 11 bankruptcy cases are legion.[1] A perception exists that bankruptcy creates a "feeding trough" for attorneys, accountants and investment bankers.[2] Several courts have suggested that professionals view bankruptcy cases, particularly chapter 11 cases, as a "cash cow."[3] These complaints, and others like them led to the provision in the Bankruptcy Reform Act of 1994 which tightened the standards under which bankruptcy courts award fees.[4]

The raw numbers are staggering. According to the New York Law Journal, in the four years from 1989 through 1992, professionals earned almost $770 million in fees from business bankruptcies filed in the Bankruptcy Court for the Southern District of New York.[5] A 1992 report indicates that the

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1. Fees have been a topic of concern and discussion for the American Bankruptcy Institute, the National Conference of Bankruptcy Judges, and the United States Trustee Program. *See* Symposium, *Paying the Piper: Rethinking Professional Compensation in Bankruptcy*, 1 AM. BANKR. INST. L. REV. (1993); BANKRUPTCY REFORM STUDY PROJECT, AMERICAN BANKRUPTCY LAW INSTITUTE, PROFESSIONAL COMPENSATION: DOES BANKRUPTCY COST TOO MUCH? (1995); AMERICAN BANKRUPTCY INSTITUTE NATIONAL REPORT ON PROFESSIONAL COMPENSATION IN BANKRUPTCY CASES (G.R. Warner rep. 1991) [hereinafter ABI NATIONAL REPORT]; PROGRAM, ANNUAL MEETING OF THE NATIONAL CONFERENCE OF BANKRUPTCY JUDGES (Oct. 1995); *Professional Fees in Bankruptcy: Oversight Hearings Before the Subcomm. on Courts and Administrative Practice of the Senate Comm. on the Judiciary*, 102d Cong., 2d Sess. 55–72 (1992) (statement of Marcy J.K. Tiffany, U.S. Trustee Region 16, Cent. Dist. of Calif.) [hereinafter *Bankruptcy Hearings*]; *Id.* at 101–08 (statement of John E. Logan, Director, Executive Office for U.S. Trustees); United States Trustee Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. § 330 (Draft, Jan. 30, 1996) [hereinafter U.S. Trustee Guidelines].

2. *Metzenbaum Charges Fees Leave Little for Those the System Is Supposed to Protect*, 19 Pens. Rep. (BNA) No. 13, at 527 (Mar. 30, 1992).

3. *See, e.g., In re* Drexel Burnham Lambert Group, Inc., 133 B.R. 13, 26 (Bankr. S.D.N.Y. 1991) ("[W]e have been left with the strong impression that for [financial advisors and investment bankers] the debtor is the cash cow to be milked, Chapter 11 the milking parlor, and the Judge the milking stool."); *In re* Chas. A. Stevens & Co., 105 B.R. 866, 872 (Bankr. N.D. Ill. 1989) ("The estate is not a cash cow to be milked to death by professionals seeking compensation for services rendered to the estate which have not produced a benefit commensurate with the fees sought.").

4. Pub. L. No. 103-394, § 224, 108 Stat. 4130 (1994).

5. Edward A. Adams, *Bankruptcy Fees Here Are Highest in Nation*, N.Y.L.J., June

Drexel Burnham Lambert Group spent $109 million on professional fees during thirty-four months in chapter 11; Eastern Air Lines and its affiliates spent $95 million during thirty-six months in bankruptcy; Federated Department Stores and its affiliates spent $120 million during twenty-four months in bankruptcy; and the Revco Drug Store chain spent $90 million during forty-five months in chapter 11.[6] One suspects that these numbers provoke outbursts of anger from creditors who receive relatively small distributions on their claims.[7] Economic literature suggests that the direct costs of chapter 11 are significantly higher than for out-of-court restructurings.[8]

Complaints about professional fees grow out of other complaints about chapter 11. Large professional fees are indicative of large amounts of litigation.[9] Litigation in chapter 11 carries costs beyond the professional fees involved; it slows down formulation and confirmation of the plan of reorganization, distracts management's attention from running the business, and discourages customers, suppliers and lenders from transacting with the debtor. A number of commentators have suggested that chapter 11 could be improved by reducing the amount of litigation.[10]

Traditionally, efforts to reduce professional and administrative costs in bankruptcy have resulted in tighter court control over fees.[11] Recent amendments to the Bankruptcy Code return once again to the traditional approach, seeking to control fees through closer regulation by the bankruptcy court.[12]

Will the tighter fee standards under the 1994 amendments permit courts

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24, 1993, at 1.

6. Claudia MacLachlan, *Anger Rises over Bankruptcy Fees*, NAT'L L.J., Mar. 9, 1992 at 1.

7. *See In re* Gillett Holdings, Inc., 137 B.R. 475, 481 (Bankr. D. Colo. 1992) ("Few rulings in a bankruptcy case generate more outrage from the public, anxiety among attorneys, and tribulation for judges than the compensation of officers of an estate...."), quoting *In re* CF&I Fabricators, Inc., 131 B.R. 474, 480 (Bankr. D. Utah 1991); George Anders, *Chapter 11 System Provokes Outburst from Revco's Chief*, WALL ST. J., June 28, 1991, at A5.

8. Stuart C. Gilson et al., *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315 (1990).

9. I use the term "litigation" to refer to adversary proceedings (*see* FED. R. BANKR. P. 7001), motions or objections filed with the court, threats to take such steps, negotiations, and settlement discussions.

10. Lynn LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganizations of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990); Hon. Steven W. Rhodes, *Eight Statutory Causes of Delay and Expense in Chapter 11 Bankruptcy Cases*, 67 AM. BANKR. L.J. 287 (1993); Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority Claims*, 27 J. FIN. ECON. 285 (1990).

11. 3A JAMES W. MOORE ET AL., COLLIER ON BANKRUPTCY ¶ 62.02 (14th ed. 1975) (outlining the development of tighter court controls from 1800 to 1975) [hereinafter COLLIER 14th ed.].

12. The Bankruptcy Reform Act of 1994 amended 11 U.S.C. § 330(a) to require that bankruptcy courts disallow compensation for "services that [are] not either reasonably likely to benefit the debtor's estate or necessary in the administration of the case." Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 224(b), 108 Stat. 4130 (1994). The amendments also provide that the court may award compensation less than the amount requested on its own motion. *Id.* The National Bankruptcy Conference's recent report on reforming the Code concurred in the latter change, and suggested the Bankruptcy Code should specifically authorize courts to review professional fees in all cases, whether or not a party in interest files an objection. NATIONAL BANKRUPTCY CONFERENCE, REFORMING THE BANKRUPTCY CODE 301 (1994) (reprinted by Matthew Bender & Co., Inc.) [hereinafter REFORMING THE BANKRUPTCY CODE].

to effectively control fees, reign in costs, and resolve these problems? The answer, resoundingly, is no. The recent amendments are an attempt to cure a broken leg with a Band-Aid.® Complaints about the high professional costs of bankruptcy have been around as long as the national bankruptcy laws.[13] One hundred twenty-five years of experience tells us that efforts to control costs through after-the-fact court review of fees do not work. A serious reform effort requires starting with a fresh slate and correcting the structural idiosyncracies that make fees higher in bankruptcy.

I contend that fees are higher in bankruptcy because a fundamental flaw in bankruptcy's priority system lets the parties treat professional costs as externalities—costs ignored by parties to a transaction because they are incurred by other members of society.[14] Elsewhere, consumers engage in a cost-benefit analysis[15] before purchasing goods and services because limited resources constrain choice. In chapter 11, decisions about whether to purchase professional services are left in the hands of the debtor-in-possession and official committees of creditors or shareholders, who are permitted to spend other people's money to benefit themselves. Parties thus may proceed with litigation without considering whether the expected benefits warrant incurring the associated costs. This leads to overspending.

The key to controlling professional costs, and to controlling litigation, lies in a change in the system for compensating professionals.[16] An effective system must correct the misallocation that permits one group to spend, while another group pays.

This article examines the current system for compensation in chapter 11, identifies the obstacles the system poses to effective control of professional costs, and proposes modifications to the Bankruptcy Code and Rules that would promote cost-concious purchasing of professional services and a price-sensitive market for those services. Part I demonstrates how the current compensation system sets up professional costs as externalities, thereby encouraging parties to purchase services without regard to cost. Part I further examines why the players (the debtor, committees and individual creditors and shareholders) otherwise fail to take an active role in regulating fees. Part II shows how court

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13. Complaints about administrative costs in bankruptcy are nothing new. In 1909, the Second Circuit Court of Appeals commented: "Nothing contributed so much to bring about the repeal of the act of 1867...as the large expense of administration, the small estates being entirely absorbed in fees." *In re* Oakland Lumber Co., 174 F. 634, 637 (2d Cir. 1909). *See also* COLLIER 14th ed., *supra* note 11, ¶ 62.02.

14. "Externalities" are costs or benefits of a transaction incurred or received by other members of society (in this case the other stakeholders in bankruptcy), but not taken into account by the parties to a transaction. Externalities lead to market failure because the private decisionmaker considers only its private cost (the best alternative use of the resources that go into the proposed course of action), and not the social cost borne by others. *See, e.g.*, RICHARD G. LIPSEY ET AL., ECONOMICS 402–03 (10th ed. 1993).

15. Weighing costs against likely benefits.

16. Elsewhere, commentators have noted that attorney compensation arrangements may affect the number, type and validity of lawsuits filed and amounts spent on litigation. *See, e.g.*, Janet C. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991); Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L., ECON. & ORGANIZATION 143 (1986); Philip J. Mause, *Winner Takes All: A Re-examination of the Indemnity System*, 55 IOWA L. REV. 26 (1969); Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 139 (1984).

review of fees is counterproductive to efforts to control costs, and is an anachronistic relic from practice under the Bankruptcy Act. Part III proposes modifications to the Bankruptcy Code that would correct the perverse economic incentives to overspend. I propose that fees and expenses incurred by an official committee be charged against distributions to the class or classes that the committee represents. Similarly, fees incurred by the debtor-in-possession's professionals would be allocated among all classes of unsecured claims and equity interests in proportion to the value of the property distributed to each class under the plan of reorganization. Finally, I propose eliminating court review of professional fees, except where a party in interest objects.

## I. THE CURRENT COMPENSATION SYSTEM

Any decision on how to control professional costs in bankruptcy first requires an examination of what the system tries to accomplish by permitting payment of compensation to professionals out of the debtor's estate. Except to professionals, compensation is not a goal of bankruptcy. Instead, "[c]ompensation is the lubricant which makes the bankruptcy machinery work when applied in the proper places and the proper amount."[17]

### *A. Decisionmakers and the Basic Chapter 11 Process*[18]

Chapter 11 reorganization proceedings,[19] at their core, address two fundamental issues: (1) the size of the debtor's estate (and how it can be increased), and (2) division of the estate.[20] In a sharp departure from prior law, the Bankruptcy Code gives the parties with an economic stake in the enterprise the power to decide what should be done with the assets and how the estate should be divided.[21] Under the Bankruptcy Act, government officials or entities appointed by government officials played a major role in deciding how the business should be run and how it should be divided.[22] Creditors and equity

17. *In re* King Resources Co., 651 F.2d 1349, 1352 (10th Cir. 1980), *cert. denied*, 454 U.S. 881 (1981); *see also In re* Seneca Oil, Co., 65 B.R. 902, 908 (Bankr. W.D. Okla. 1986).

18. Readers familiar with the basic workings of chapter 11 may wish to skip ahead to Part I.B. (The Decision to Purchase Professional Services).

19. This article focuses on the allowance of fees in chapter 11, although some aspects of my proposal could apply to chapter 7 and chapter 13 cases as well.

20. Most of the issues and disputes in reorganization cases fall within one of these two categories, although there is some overlap. For example, the debtor might propose investing in a risky business venture, where senior creditors bear the risk of loss, but only junior creditors or shareholders stand to benefit from the returns on that investment.

21. H.R. REP. NO. 595, 95th Cong., 1st Sess. 224, 232–36 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6191–96. Creditors and equity holders, whose money is at stake, are in a better position to make business judgments about what to do than judges and lawyers. The legislative history to the Bankruptcy Reform Act of 1978 is rife with comments about the benefits of creditor participation and the evils resulting from nonparticipation. *See, e.g., id.* at 91–93, 96–99, 104–05, 235–36, *reprinted in* 1978 U.S.C.C.A.N. at 6052–54, 6057–61, 6065–67, 6194–96; Report of the Commission on the Bankruptcy Laws of the United States, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. I, at 104–06, and pt. II, at 218–20 (1973) [hereinafter COMM'N REP.].

22. In Chapter VII liquidation cases, the bankruptcy judge (i.e., the district court judge sitting in bankruptcy) or the bankruptcy referee appointed a trustee in cases where the creditors failed to qualify or a vacancy occurred. Bankruptcy Act §§ 2a(17) and 44(a), 11 U.S.C. §§ 11a(17) and 72(a) (repealed 1978); FED. R. BANKR. P. 209(b) (repealed by Bankruptcy Reform Act of 1978). The legislative history to the 1978 Reform Act noted how this often functioned as a patronage system and affected perceptions of bankruptcy referees' impartiality. *See* H.R. REP. NO. 595, *supra* note 21, at 92–93, *reprinted in* 1978 U.S.C.C.A.N. at 6053–54; COMM'N

holders had only a limited ability to determine the form of the reorganization.[23]

In contrast, the Bankruptcy Code leaves most of the business decisions to the parties, with the bankruptcy court acting as an arbiter of disputes.[24] A debtor filing for relief under chapter 11 of the Bankruptcy Code generally stays in possession of its business.[25] The debtor-in-possession or "DIP," who stands in the place of the trustee,[26] may operate its business unless, on request of a party in interest, the court orders otherwise.[27] The debtor is given a relatively short breathing space in which the debtor, creditors, shareholders and other parties in interest can determine what is to be done with the business.[28]

The debtor exits chapter 11 through the filing and confirmation of a plan of reorganization.[29] A plan must specify what will be done with the debtor's business and what distributions, if any, will be made to the various classes of claims and equity interests.[30] Creditors and shareholders are given an opportunity to vote on the plan.[31] The plan may be confirmed if a majority of the claims and interests vote to accept,[32] or may be "crammed down" despite the fact that a class votes to reject if the bankruptcy court determines that certain standards have been satisfied.[33]

Of course, not all "parties" can actively participate in the negotiation of a plan of reorganization, particularly where the debtor may have hundreds, thousands, or hundreds of thousands of stakeholders. The primary players in a chapter 11 case are the DIP's management, the official committee of unsecured creditors, and the official committee of equity holders, if one is appointed.

The powers of the DIP reside in the debtor's management[34] and board of

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REP., *supra* note 21, at pt. I, at 4, 92–93. In Chapter X corporate reorganizations, the district court judge, sitting in bankruptcy, appointed a trustee who then managed the business. Bankruptcy Act §§ 156, 157, 189, 11 U.S.C. §§ 556, 587, 589 (repealed 1978). No person was permitted to become an officer or director of the debtor without approval of the court. Bankruptcy Act § 191, 11 U.S.C. § 591 (repealed 1978). Rigid adherence to absolute priority was required in Chapter X reorganizations. *See* 6A COLLIER 14th ed., *supra* note 11, ¶ 11.06.

23. Corporate arrangements under Chapter XI gave greater control to the debtor, as the debtor was left in possession (unless the case had been converted from a Chapter VII case in which a trustee had been appointed, Bankruptcy Rule 11–18(b) (repealed 1978)) and given the authority to make business decisions, subject to control by the court). Bankruptcy Act § 341, 11 U.S.C. § 741 (repealed 1978); FED. R. BANKR. P. 11–18(b) (repealed 1978). In Chapter XI, however, a debtor's plan could not affect the rights of secured creditors or equity holders, but only modify or alter rights of unsecured creditors. Bankruptcy Act §§ 356, 357, 11 U.S.C. §§ 756, 757 (repealed 1978); SEC v. U.S. Realty & Improvement Co., 310 U.S. 434 (1940); *see also* 9 COLLIER 14th ed., *supra* note 11, ¶ 8.01[3].

24. *See* H.R. REP. NO. 595, *supra* note 21, at 88–89, 224–25, *reprinted in* 1978 U.S.C.C.A.N. at 6049–51, 6183–85.

25. In chapter 11 cases, the debtor becomes the DIP unless a trustee is appointed. *See* 11 U.S.C. §§ 1101(1) and 322 (1994). The DIP has virtually all of the rights, powers and duties as a trustee. *See* 11 U.S.C. § 1107.

26. 11 U.S.C. § 1107.

27. 11 U.S.C. §§ 363, 1108.

28. *See, e.g.*, 11 U.S.C. §§ 362, 1121(b).

29. 11 U.S.C. § 1129.

30. 11 U.S.C. § 1123.

31. 11 U.S.C. § 1126; FED. R. BANKR. P. 3018.

32. *See* 11 U.S.C. §§ 1126 and 1129(a)(8), (10). The other standards of 11 U.S.C. § 1129(a) must also be satisfied.

33. *See infra* notes 64–67 and accompanying text for a discussion of the absolute priority rule.

34. Most often, a chapter 11 debtor is a legal "person": a corporation or a partnership. Individuals, however, may file for relief under chapter 11. *See* 11 U.S.C. §§ 101(41), 109(d);

directors.[35] Management wields the power to operate the business,[36] make decisions in the ordinary course without interference from creditors,[37] and even make decisions outside of the ordinary course of business, so long as no creditor requests a hearing.[38] Management also has the exclusive right to file a plan of reorganization for the first 120 days of the chapter 11 case.[39] Thus, debtor's management has significant power over disposition of the assets, and the division of the estate. Debtor's management, acting as the DIP, may retain attorneys, accountants, and other professionals.[40] Professionals retained by the DIP receive compensation from the debtor's estate.[41]

Individual stakeholders participate through their vote to accept or reject a plan. The vote on the plan, however, comes after decisions on what to do with the business and how to divide the estate have been made. Although the Bankruptcy Code nominally permits individual stakeholders to participate earlier,[42] practical obstacles prevent most creditors or equity holders from doing so.[43] Often, the cost of monitoring the debtor's actions and participating in plan negotiations greatly exceeds the amount of any likely recovery in the chapter 11 case. Except in the rare instance where a stakeholder can show it made a "substantial contribution" in the chapter 11 case, the Bankruptcy Code does not permit unsecured creditors[44] or equity holders to recover their costs for professional services from the estate.[45]

The Bankruptcy Code attempts to facilitate stakeholder participation through the appointment of official committees of creditors and equity

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Toibb v. Radloff, 501 U.S. 157 (1991).

35. Or in the debtor's general partner or partners if the debtor is a partnership.

36. 11 U.S.C. § 1108.

37. 11 U.S.C. § 363(c)(1).

38. *See* 11 U.S.C. §§ 102(1), 363(b).

39. 11 U.S.C. § 1121. This period is frequently extended by the courts.

40. 11 U.S.C. § 327(a).

41. 11 U.S.C. § 330(a).

42. Creditors and equity holders, as parties in interest, "may raise and may appear and be heard on any issue" in a chapter 11 case. 11 U.S.C. § 1109(b).

43. For example, in most large cases, the court enters an order limiting notice of most proceedings to official committees, the debtor, and parties who specifically request notice. *See* FED. R. BANKR. P. 2002(i). Mailing routine notices to all stakeholders may be prohibitively costly, particularly in large cases with 50,000 or 100,000 creditors and equity holders. Even in a case with just 1000 creditors and equity holders, mailing a one page notice would cost $320 for postage, plus the costs of copies and envelopes. For larger documents, postage costs would be even higher. Most large chapter 11 cases (even short of the "megacases") have more than 1000 parties in interest.

44. Oversecured creditors may recover fees incurred in collecting the obligation pursuant to 11 U.S.C. § 506(b).

45. To recover costs under 11 U.S.C. § 503(b)(3)(D) and (b)(4) for making a substantial contribution, the services of the professional must "directly and materially" contribute to the reorganization, and the benefit to the estate must be more than an incidental one arising from activities the applicant pursued in protecting his or her own interests, because creditors are presumed to be acting in their own interests unless their efforts transcend self-protection. *See, e.g.*, Lebron v. Mechem Financial, Inc., 27 F.3d 937, 944 (3d Cir. 1994); Manufacturers Hanover Trust Co. v. Bartsh (*In re* Flight Transp. Corp. Sec. Litig.), 874 F.2d 576, 581 (8th Cir. 1989); Haskins v. United States (*In re* Lister), 846 F.2d 55, 57 (10th Cir. 1988); Pierson & Gaylen v. Creel & Atwood (*In re* Consolidated Bancshares, Inc.), 785 F.2d 1249, 1252–54 (5th Cir. 1986). It is hard to imagine an individual stakeholder who would be willing to incur liability for fees that were *not* primarily for its own benefit. Consequently, claims for "substantial contribution" do not significantly alter the incentives for individual stakeholders to participate.

holders.[46] The appointment of committees is meant to increase creditor involvement in the reorganization proceedings.[47] The Code requires the United States Trustee to appoint a committee of unsecured creditors, and permits the appointment of additional committees as the United States Trustee deems appropriate.[48] Like the debtor's counsel and financial advisors, professionals retained by official committees receive payment from the debtor's estate.[49]

Payment of professionals for the DIP and official committees from the estate facilitates creditor participation and permits the debtor to effectively reorganize.[50] Professionals are the medium through which the parties participate in the bankruptcy case.[51] In shifting from a reorganization process controlled by government officials or trustees appointed by government officials, to a process controlled by the stakeholders,[52] some incentives for stakeholders to participate had to be provided. The legislative history to the Bankruptcy Reform Act of 1978 is rife with comments about the benefits of creditor participation and the evils resulting from nonparticipation.[53]

Notwithstanding the need to encourage stakeholder participation in the reorganization process, the mechanism created for payment of professionals had unforseen consequences. A fundamental flaw in the system leads to overspending, and higher costs in bankruptcy.

### *B. Ex Ante—The Decision to Purchase Professional Services*

In thinking about control of fees under the current system, it is useful to consider the process in two distinct segments: ex ante, before services are rendered, and ex post, after services are rendered but before payment from the estate. A full understanding of the fee problem requires consideration of how and why a committee or DIP decides to purchase professional services ex ante,

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46. 11 U.S.C. §§ 1102, 1103; H.R. REP. NO. 595, *supra* note 21, at 401, *reprinted in* 1978 U.S.C.C.A.N. at 6357.

47. H.R. REP. NO. 595, *supra* note 21, at 235, *reprinted in* 1978 U.S.C.C.A.N. at 6194–95.

48. 11 U.S.C. § 1102(a)(1) provides:

> (a)(1) [A]s soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

In considering whether to appoint additional committees, the United States Trustee balances the increased costs associated with a separate committee against the affected constituency's need for separate representation in the case. *See* UNITED STATES TRUSTEE PROGRAM, CHAPTER 11 POLICY INITIATIVE, U.S. DEPT. OF JUSTICE 87–91 (Mar. 1993).

49. 11 U.S.C. § 330(a).

50. H.R. REP. NO. 595, *supra* note 21, at 235, *reprinted in* 1978 U.S.C.C.A.N. at 6194–95 (Committees are more active in chapter XI cases because the law provides for compensation for a counsel to the committee at the expense of the estate, even if no plan is confirmed in the case).

51. Indeed, the Bankruptcy Code requires use of professionals in many instances, including the preparation of pleadings related to using, selling or leasing property out of the ordinary course of the debtor's business, assuming or rejecting executory contracts, or proposing a plan of reorganization.

52. The term "stakeholder" will refer to "creditors" holding "claims" against the debtors' estate, *see* 11 U.S.C. § 101(5), (10), as well as holders of equity interests (e.g., shareholders of corporate debtors and partners in partnership debtors).

53. *See, e.g.*, H.R. REP. NO. 595, *supra* note 21, at 91–93, 96–99, 104–05, 235–36, *reprinted in* 1978 U.S.C.C.A.N. at 6052–55, 6057–61, 6065–67, 6194–96; COMM'N REP., *supra* note 21, pt. I, at 104–06, and pt. II, at 218–20.

as well as the problems with ex post review.

The current system leaves decisions about what services to purchase in the hands of the DIP or official committees. What constrains a DIP or an official committee from leaving no stone unturned in the pursuit of reorganization or recovery? Outside of bankruptcy, the cost of professional services constrains an individual's or corporation's use of those services. Basic economic theory assumes that consumers of goods and services make choices between alternatives to maximize their utility. Choices are limited because income and resources are limited.

In bankruptcy, one would expect stakeholders and the DIP to act rationally to limit payment to professionals. As noted above, chapter 11 proceedings at their core address two fundamental issues: (1) the size of the pie (and how it can be increased), and (2) the division of that pie. Economic theory (and common sense) suggests that the parties should spend for professional services that increase the size of the pie so long as the probable benefit resulting from those services is greater than the expected cost. Similarly, parties should share an interest in keeping costs associated with division low because in this sense bankruptcy is a zero sum game. Every dollar that goes to professionals cannot go to a stakeholder.

Outside of bankruptcy, we expect rational business people will not incur costs greater than the expected benefit. In these days of fiscal restraint, one would guess that a manager's approval of a $100,000 bill for attorneys' fees incurred in successfully defending a suit seeking $80,000, might be grounds for dismissal. A law firm submitting such a bill runs a risk of reduced payment, or of losing the client. Outside of bankruptcy, business people weigh predicted costs and benefits and choose accordingly.

In bankruptcy, this common sense approach disintegrates. Many of the system's participants doubt that the debtor's management or committee members can effectively control professional costs.[54] Periodic reports of cases where professional fees and business losses consumed the entire estate provide solid footing for these doubts. An examination of how decisions are made to purchase professional services in chapter 11 demonstrates why parties ignore costs.

Fees expended to resolve the second major issue in chapter 11 cases—division of the estate—highlight the basic economic infirmity of the current system. Consequently, this article will focus on fees incurred in connection with priority disputes.[55]

*1. The Fight Over Priority*

Division of the estate, in the absence of an agreement among the parties, follows a system of priorities established by both the Bankruptcy Code and state law. Secured claims stand first in line, at least with respect to the collateral

54. *See* CODE REVIEW PROJECT, REFORMING THE BANKRUPTCY CODE, *supra* note 12, at 310, and other materials discussed in the introduction, *infra* notes 1–16 and accompanying text.

55. The problems that lead the parties to disregard costs also apply to professional services aimed at increasing the size of the estate. I would apply the proposals contained in Part III to all fees, without attempting to distinguish between fees for services designed to increase the size of the estate and those for services purchased in connection with priority disputes.

securing payment of those claims.[56] Administrative expenses, including fees for professionals retained by the DIP, any trustee, or official committees, come next, and must be paid in full, in cash, on the effective date of the plan.[57] After administrative expenses come involuntary gap claims,[58] then priority claims.[59] A bankruptcy court cannot confirm a plan that does not provide for payment of administrative expenses, priority claims and priority tax claims in full.[60] Unsecured claims fall behind priority claims in the pecking order. Generally, all unsecured claims, whether contractual or tort claims, share equal priority. However, inter-creditor agreements may modify the relative priority of claims.[61] These subordination agreements are enforceable in bankruptcy.[62] After creditors come the equity holders: shareholders for corporations, and partners, whether limited or general, for partnerships. Priority among equity holders may vary, depending on whether shares issued are preferred as to dividends, have a liquidation preference, or are simply common shares.

This system of priorities, along with the "best interest test" and the "absolute priority rule," set the minimum treatment a class of claims or equity interests may be forced to accept in absence of an agreement between the parties. The "best interest test" requires that distributions under a plan must be equal to what each creditor or shareholder would receive in a chapter 7, and cannot be waived by class vote.[63] For more junior classes of claims and interests, this may well be nothing.

On the other hand, the "absolute priority rule" of section 1129(b) gives a

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56. Entities who hold liens on property of the debtor to secure repayment of a debt have a property interest in the collateral. The Bankruptcy Code recognizes, and provides special protection to, that property interest. *See, e.g.*, 11 U.S.C. §§ 361, 362(d), 506, 1129(b)(2)(A). The claims, however, are "secured" only to the extent of the value of the collateral, unless the creditor makes the election under 11 U.S.C. § 1111(b)(2). Further, secured claims need not be paid in full on the effective date. *See* 11 U.S.C. § 1129(b)(2)(A).

57. *See* 11 U.S.C. §§ 330, 503, 1129(a)(9)(A).

58. Claims in an involuntary proceeding that arise after commencement of the case, but before entry of an order for relief or an order appointing a trustee. *See* 11 U.S.C. § 502(f). Involuntary gap claims must be paid in full, in cash, on the effective date of the plan. *See* 11 U.S.C. § 1129(a)(9)(A).

59. Priority claims include certain employee wage and benefit claims, certain claims against grain storage or fish storage and processing facilities, and consumer deposit claims. *See* 11 U.S.C. § 507(a)(3)–(a)(6). These priority claimants must receive payment in full, in cash, on the effective date of the plan unless the class votes to accept the plan. *See* 11 U.S.C. § 1129(a)(9)(B). Priority tax claims (defined in 11 U.S.C. § 507(a)(8)) must receive deferred cash payments, with a present value equal to the amount of the taxes, over a period not to exceed six years from the date of assessment. *See* 11 U.S.C. § 1129(a)(9)(C).

60. 11 U.S.C. § 1129(a)(9). If the debtor cannot satisfy these claims from its assets, then the court may convert the case to chapter 7 or dismiss it completely. *See* 11 U.S.C. § 1112.

61. One creditor may agree with another, and with the debtor, that the first is entitled to seek payment of its claim in full, or in part, before the second creditor receives payment from the debtor. The subordination agreement may affect priority as to all creditors, or just the parties to the agreement. *See, e.g.*, 2 DAVID G. EPSTEIN ET AL., BANKRUPTCY § 6-93 (1992) (provides a further explanation of subordination agreements).

62. 11 U.S.C. § 510(a).

63. 11 U.S.C. § 1129(a)(7)(A) permits a court to confirm a plan only if each holder of a claim or interest in an impaired class (i) "has accepted the plan," or (ii) will receive property with a present value equal to the amount each holder would receive in a chapter 7 liquidation. Despite the acceptance alternative, each individual creditor can block confirmation (and receive more) by not accepting the plan. Effectively, a plan must provide for distributions at least equal to liquidation value. This requirement cannot be waived by class vote. *See* H.R. REP. NO. 595, *supra* note 21, at 412, *reprinted in* 1978 U.S.C.C.A.N. at 6368.

class that votes to reject the plan the right to insist on full going concern value to itself and senior classes.[64] Distribution of the debtor's going concern value may occur through transfer of the debtor's assets (e.g., through payment of cash or turnover of property), or through the issuance of future "claims" against the debtor in the form of notes, debt securities, stock, warrants to purchase stock, or other equity interests.[65] Under the "absolute priority rule," a class that votes to reject the plan must receive payment in full, albeit over time, or junior classes of claims or interests cannot receive any distribution under the plan. Similarly, dissenting classes of equity interests must receive payment of the value of their interest,[66] or junior classes of interests can receive nothing. At the same time, classes senior to the non-accepting class cannot be paid more than 100% of their claims.[67]

Thus, the Bankruptcy Code leaves the decision on how to allocate the difference between liquidation value and going concern value to negotiation among the parties.[68] The limits established by the best interest test and absolute priority rule naturally act as a backdrop for the parties' negotiations.

Depending on the size of the estate and the amount of claims, the debtor's going concern value may not be sufficient to satisfy, or even reach, all of the claims against or interests in the estate. Stakeholders whose priority leaves them "out of the money," cannot use their vote against the plan to block confirmation. Given that a class may insist on allocation of the debtor's full value to itself and senior classes, and "underwater" classes[69] cannot block confirmation by a no vote, why would any class receiving less than full payment agree to allocate value to junior classes? Litigation.

*2. Who Benefits?*

The first step in considering how costs might be controlled ex ante is an examination of why a committee or DIP purchases professional services. A committee or the DIP might use litigation or the threat of litigation to gain leverage in the absolute priority debate, or to shape the reorganized company in a fashion that benefits their constituency (whether creditors, equity holders or management). Questions surrounding division of the estate frequently spark hotly contested battles in a chapter 11 case. Allocation of assets to one set of stakeholders reduces the assets available to satisfy other stakeholders, making bankruptcy a zero sum game. The fight over priority, further, provides the clearest illustration of the perverse incentives that lead to overspending.

The Bankruptcy Code provides a long list of litigable issues that might

64. A court may "cramdown" a plan of reorganization, even where one or more classes votes to reject, "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). The "fair and equitable" requirement gives us the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B), (C).

65. *See, e.g.*, 11 U.S.C. §§ 1123(a)(5), 1145.

66. Or, the fixed liquidation preference, or fixed redemption price, whichever is greater. *See* 11 U.S.C. § 1129(b)(2)(C)(i).

67. H.R. REP. NO. 595, *supra* note 21, at 414, *reprinted in* 1978 U.S.C.C.A.N. at 6370 ("One requirement applies generally to all classes before the court may confirm under [§ 1129(b)]. No class may be paid more than in full.").

68. *See* H.R. REP. NO. 595, *supra* note 21, at 224, *reprinted in* 1978 U.S.C.C.A.N. at 6183.

69. I.e., classes "out of the money."

affect the division of the debtor's estate. Junior stakeholders might challenge the claimed priority of more senior classes by: objecting to the allowance of their claims;[70] seeking equitable subordination of the senior claims or interests;[71] disputing the enforceability of a contractual subordination agreement;[72] or, requesting avoidance of a claimed lien on the basis that it was not properly perfected[73] or constituted a preferential transfer.[74] Further, junior stakeholders might challenge confirmation on the basis that the valuation of the debtor's business is too low, so that the plan does not satisfy the absolute priority rule. Appraising the value of an ongoing business is not an exact science, and may provide a host of points for dispute.[75] Services provided by accountants, financial advisors or investment bankers may provide factual ammunition for these fights.

Litigation and the threat of litigation over these and other issues may explain why the parties may agree to a plan that "violates"[76] priority and allocates value to classes "out of the money."[77] A class may use its ability to delay the chapter 11 case to encourage other parties to compromise. Professional services are the medium through which this leverage is created and exercised. The ability to purchase professional services is the ability to push for

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70. 11 U.S.C. § 502.

71. 11 U.S.C. § 510(c). Equitable subordination requires a showing that: (i) the claimant engaged in some type of inequitable conduct; (ii) the misconduct resulted in injury to the creditors of the debtor or conferred an unfair advantage on the claimant; and (iii) equitable subordination of the claim is not inconsistent with the provisions of the bankruptcy laws. *See, e.g.*, Machinery Rental, Inc. v. Herpel (*In re* Multiponics), 622 F.2d 709, 713 (5th Cir. 1980). Section 510(c) only permits subordination of "all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest...." 11 U.S.C. § 510(c).

72. Section 510(a) provides: "A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under nonbankruptcy law." 11 U.S.C. § 510(a).

73. *See* 11 U.S.C. § 544(a).

74. *See* 11 U.S.C. § 547(b).

75. The uncertainty over valuations and the difficulty of proving them in court led, in part, to a change in the confirmation standards from the Bankruptcy Act. The House Report states:

> [T]he application of [the absolute priority] rule requires a full going concern valuation of the business. Though valuation is theoretically a precise method of determining the creditors' and stockholders' rights in a business, more often the uncertainty of predicting the future, required in any valuation, is a method of fudging a result that will support the plan that has been proposed. As Peter Coogan has aptly noted, such a valuation is usually "a guess compounded by an estimate". In a reorganization where time is of the essence, the length and uncertainty of the valuation process is no longer justified in every case.

H.R. REP. NO. 595, *supra* note 21, at 222, *reprinted in* 1978 U.S.C.C.A.N. at 6181.

76. Some economic literature refers to the allocation of value to stakeholders out of the money as "violations" of priority. *See* Weiss, *supra* note 10, at 291 (suggesting that the ability to delay confirmation through litigation and imposing costs for professionals on the estate leads to "violations" of priority). "Violation" in this context is a pejorative term. The parties may settle, both to avoid the costs of litigation, and because the claims asserted have merit.

77. *Cf.* LoPucki & Whitford, *supra* note 10, at 148–49 ("[W]hile we agree that both direct litigation costs and fear of delay are factors that encourage plan proponents to include equity in the distributions made by even clearly insolvent companies, we believe that these factors are insufficient to explain the size of the distributions to equity."). Professors LoPucki and Whitford suggest that a generalized belief that reorganization is best accomplished through consensual plans, held by many bankruptcy professionals and bankruptcy judges, may explain why equity receives distributions in cases where creditors receive less than payment in full. *Id.* at 154–58.

compromise and a piece of the pie.

*3. Who Pays?*

It is often said that the "debtor" pays professional fees, but that is not accurate.[78] Instead, the absolute priority rule gives the bill to the last class of creditors or shareholders still "in the money."

Professional fees have first priority, after secured claims, as an administrative expense.[79] Thus, professionals receive payment before any distribution is made to unsecured creditors or shareholders.[80] The absolute priority rule gives a dissenting class of claims or equity interests the right to insist on payment of their claims or interests in full before junior classes receive anything.[81] Administrative expense priority for all professional fees, along with senior creditors' right to insist on full payment, means that increases in fees reduce the value allocated to junior classes. Classes junior to the "last class in the money" receive nothing, except by consent, so fee awards do not affect their distributions. The last class in the money thus foots the bill for both fees associated with services designed to increase or preserve the value of the estate,[82] and for fees incurred in connection with inter-creditor disputes.

To provide a numerical example, suppose the debtor is worth $1,000,000, and has senior unsecured claims totalling $600,000, subordinated unsecured claims of $400,000, and common stock. As Table A demonstrates, before allowance for professional expenses, senior unsecureds and subdebt would receive full payment and common stockholders would receive nothing. Assume further, that the DIP incurred $70,000 in professional expenses, the senior unsecured creditors' committee $50,000, the subdebt $30,000 and the common shareholders $50,000, for total professional fees of $200,000. Professional fees come off the top, so the senior unsecured claimants would still receive full payment, but the unsecureds would receive a pro rata share of only $200,000.

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78. Compensation for committees' and DIPs' professionals is paid from the estate. 11 U.S.C. §§ 330(a), 503(b)(2).

79. *See* 11 U.S.C. §§ 503(b)(2), 507(a)(1).

80. *See supra* notes 56–60 and accompanying text.

81. *See supra* notes 64–67 and accompanying text.

82. To the extent professional costs preserve the debtor's going concern value for the benefit of creditors who would receive little or nothing in liquidation, their allocation to the last class in the money makes sense. Those classes benefitted from the reorganization at the expense of a delay in recovery to more senior creditors, and therefore should pay. Contractual subordination or preference provisions between or among the classes benefitted may further justify allocation only to the last class in the money. However, the cogency of this reasoning falters in circumstances where the particular subordination or preference provision does not provide for payment of attorney or professional fees incurred by the senior creditor or shareholder. Elsewhere, the Bankruptcy Code requires that an agreement must specifically provide for the payment of such fees before they can be charged to the other party to the agreement. *See* 11 U.S.C. § 506(b) ("To the extent that an allowed secured claim is secured by property the value of which...is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges *provided for under the agreement under which such claim arose.*") (emphasis added); *see also* United States v. Ron Pair Enter., Inc., 489 U.S. 235 (1989).

## Table A - Effect of Fees on Distributions Under Current System

| Class | Claim Amount | Distribution Before Fees | Fees Spent By Class | Distribution After Fees |
|---|---|---|---|---|
| **Administrative Expenses**[1] | 0[1] | 0 | $200,000 | $200,000 |
| **Senior Unsecured Claims** | $600,000 | $600,000 | $50,000 | $600,000 |
| **Subdebt Claims** | $400,000 | $400,000 | $30,000 | $200,000 |
| **Common Stock** | Shares | 0 | $50,000 | 0 |
| **DIP Fees**[2] | | | $70,000 | |
| **Total Distributions to Stakeholders** | | $1,000,000 | | $800,000 |

(1) This assumes that professional fees are the only administrative expenses allowed.

(2) DIP fees are presumed to be spent on behalf of the entire estate.

*4. The Divergence Between Costs and Benefits*

a. Professional Costs as Externalities

In economic terms, professional fees of the DIP and official committees are externalities—costs ignored by parties to a transaction because they are incurred by other members of society. The last class in the money bears the cost, while others benefit.

Allocation of all fees to the last class in the money on the basis of the benefit received might be justified if maximization of the estate were the only issue to be resolved in chapter 11 and the only issue on which fees could be expended;[83] or if the last class in the money were the only class that benefitted.[84] But, many disputes in chapter 11 arise from disagreement over how to divide the estate.[85] The last class in the money receives little apparent benefit from fees expended on inter-creditor disputes. Review of some typical litigation demonstrates how the current system allocates the cost of professional services away from the parties seeking benefits through the purchase of professional services.

Litigation between two classes expecting full payment suggests why parties have incentives to disregard costs. This litigation might occur where the debtor has sufficient assets to pay both senior unsecured debt and subordinated unsecured debt in full, but where the expected cash flow will not support cash or deferred cash payments to both groups.[86] To push senior unsecured creditors toward a plan providing for a partial cash distribution to the subdebt class, the subdebt committee considers filing an action challenging the enforceability of the subordination agreement[87] or seeking equitable subordination of the seniors' claims.[88]

If the subdebt committee acts rationally to maximize its recovery, they should weigh the benefit to be received from filing suit against the costs. Settlement theory refines the description of this analysis and suggests that each of the committees will determine the expected value of the case by: 1) multiplying the increased value of the distribution under the plan if the

83. Two regular participants in large reorganizations have proposed that fee standards be modified to limit payment of fees to professionals retained by committees to circumstances where the services substantially contributed to a feasible plan of reorganization or an increase in value of the debtor. Martin J. Whitman & David M. Barse, *Professionals Paid by Debtors Ought to Represent the Debtors' Interests*, 1 AM. BANKR. INST. L. REV. 367, 368 (1993). That analysis, however, fails to consider the role of professionals in resolving disputes over division of the estate, and the need to encourage creditors to participate in the reorganization process.

84. If the difference between going concern value and liquidation value is significant, more than one class may have benefitted from the reorganization.

85. The Bankruptcy Code contemplates the expenditure of fees for inter-creditor disputes. For example, actions to avoid an unperfected lien under 11 U.S.C. § 544(a), or to equitably subordinate a claim or interest pursuant to 11 U.S.C. § 510(c), do not increase the overall value of the debtor's business. Instead, they simply reallocate value among claimants.

86. I assume that creditors prefer to receive cash distributions rather than equity securities of uncertain value.

87. The Bankruptcy Code provides subordination agreements are "enforceable in a [bankruptcy case] to the same extent that such agreement is enforceable under applicable nonbankruptcy law." 11 U.S.C. § 510(a).

88. 11 U.S.C. § 510(c).

subdebt wins (or decreased value for the senior claimants),[89] by the probability of a judgment for the subdebt; and 2) subtracting the costs of litigation.[90] They will continue spending for professional services until they receive a settlement offer that equals or exceeds the expected net gains (i.e., the benefits obtained through a favorable judgment, less the costs of attaining that judgment) from trial.

In chapter 11, the senior unsecureds and subdebt need not subtract the costs of litigation in determining the probable benefit or when considering settlement, because they do not bear those costs. Instead, those costs only affect the value of distributions to the last class in the money. Preventing losses to a junior class has no value to either the senior unsecureds or the subdebt,[91] so the respective committees have little incentive to consider professional costs in deciding whether to file suit or to settle.

Even without actual litigation, senior creditors may purchase professional services as a form of insurance. For example, a senior creditor may seek a court order establishing the validity of a subordination agreement or prepare for potential litigation over validity to forestall challenges to their priority. Professionals paid on an hourly basis may promote purchase of prophylactic services as a way of increasing income. The committee benefits, and bears no cost.

In litigation[92] by senior classes against the last class in the money, incentives to disregard costs become incentives to increase costs. Senior creditors can spend freely, even for benefits not very probable in light of the merits, because their expenditures reduce the distribution to the last class in the money, win, lose or draw. Under the American Rule, the costs of defending a lawsuit frequently stimulate defendants to settle frivolous lawsuits.[93] The coercive effect of litigation is larger in bankruptcy. A junior class that prevails on the merits pays not only its own costs, but also fees for professionals retained by the official committee for senior creditors, creating a "reverse English rule."

A numerical illustration highlights the incentives to increase costs in this situation. Drawing on the earlier hypothetical,[94] assume that the subdebt proposes a plan in which the senior unsecureds will receive payment in full,

89. Settlement theory generally refers to the amount of plaintiff's "judgment." In bankruptcy, the litigation may seek a judgment that enhances the value of the distribution to that class, rather than a judgment for a dollar amount.

90. *See, e.g.*, William M. Landes, *An Economic Analysis of the Courts*, 14 J.L. & ECON. 61, 67 (1971); William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 267–74 (1979).

91. In a system with perfect information and no associated transaction costs, the last class in the money might negotiate or otherwise impose pressure against the two more senior classes to reduce these costs, so the externality would not cause market failure. *Cf.* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). As discussed *infra* notes 104–07 and accompanying text, a lack of information and the associated transaction costs impede the parties from bargaining to reduce professional costs to an efficient level.

92. The term "litigation" here is meant to refer both to actual motions, objections or adversary complaints filed with the bankruptcy court, and to threatened motions, objections and complaints.

93. *See, e.g.*, Lucian A. Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437 (1988); David Rosenberg & Steven A. Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3 (1985).

94. *See supra* Table A and accompanying text.

over time, and the subdebt will receive 100% of the common stock of the reorganized debtor. Senior creditors, seeking more cash, a higher interest rate or a shorter payout, threaten to oppose confirmation by objecting to the valuation of the debt securities to be distributed to their class. The committee for the senior unsecureds believes this litigation, if successful, will increase the value of their distributions by $100,000, will cost $25,000 to prosecute, and has a fifteen percent chance of succeeding. Outside of bankruptcy, a rational client would not litigate because the cost of suit ($25,000) exceeds the probable benefit ($15,000).[95]

Bankruptcy ratchets up the pressure to settle. A senior class willing to increase costs can increase the amount of the settlement it extracts from the last class in the money. Assuming that the subdebt predicts an eighty-five percent chance of winning in this litigation, if each class bore its own costs, the parties should settle at some amount between $0 and $40,000.[96] Again, the outcome is worse in bankruptcy. Settlement theory suggests the subdebt, required to bear its own costs and those of the seniors, will settle for some amount between $15,000 and $65,000.[97] As the seniors' committee threatens to spend additional dollars on litigation, the settlement range increases.

In these circumstances, the current system provides a senior committee seeking leverage in negotiations with a "heads I win, tails you lose" proposition, regardless of the merits. Payment of professionals from the "estate," i.e., from the last class in the money, permits other classes to extract value from the last class in the money simply by threatening litigation. Chapter 11 is designed to encourage settlement; this approach encourages litigation, and frivolous litigation at that.[98]

The system becomes the most egregious where classes of stakeholders out of the money[99] bring or threaten litigation against the last class in the money, or where management expends fees on behalf of the underwater classes.[100]

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95. Probable benefit is calculated by multiplying the increased value of the distribution if the senior unsecureds win ($50,000), by the probability of a judgment for the seniors (15%). *See supra* notes 89–90 and accompanying text.

96. This assumes that the subdebt would also spend $25,000 on the litigation. The settlement range is set by contrasting the seniors' expected net gain, with the subdebt's expected net loss. The seniors' net gain would be less than zero ((the increased value of the distribution ($100,000) *times* the probability of success (15%)) *minus* the expected costs ($25,000)). The subdebt's expected net loss would be $40,000. That class' expected benefit is zero (the best the subdebt can do is maintain the status quo) and its expected cost is $40,000 (15% of the 100,000 the class might lose, plus fees of $25,000).

97. Again, subdebt's expected benefit is zero, but is expected cost is $65,000 (15% of the $100,000 the subdebt might lose, plus its own costs of $25,000, plus the seniors' costs of $25,000).

98. Although the shifting of fees here might be justified, in part, by the existence of contractual subordination or preference agreements, or by statutory priorities (*see supra* note 82), the coercive effect of the fee shifting in cases of little merit, and the negative effects of excess costs on the reorganization process, outweighs any interest in preserving the parties' original bargain.

99. At the outset of a chapter 11 case, and at the time the U.S. Trustee appoints official committees, it may not be clear which class is the "last class in the money" or which classes are out of the money. Valuation of the debtor's business as a going concern is not required, except in a cramdown under 11 U.S.C. § 1129(b). Further, the debtor's value may change over the course of the chapter 11 case as a result of profits, or losses. The U.S. Trustee may, therefore, appoint an official committee to represent a class of claims or interests that may later fall out of the money under the absolute priority rule.

100. The DIP, although a fiduciary to all constituencies, may become involved in inter-

Litigation by, or on behalf of, these classes has the same coercive effects as litigation by senior creditors, without the justification of contractual or statutory subordination provisions. The presence of an official committee representing these classes at the bargaining table may pose enough of a threat that the last class in the money is encouraged to compromise to eliminate their "nuisance value."[101] Indeed, the appointment of an official committee to represent a class not clearly in the money, itself represents an allocation of value to them. Payment of professionals to such a committee from the estate takes value from more-senior creditors, although professionals, rather than the junior class, receive that value. The justification for compensating committee[102] professionals from the estate—the need to promote the involvement of creditors who otherwise might not find participation cost-effective—falls apart here. Guaranteeing a litigation war chest to parties with nothing to lose and everything to gain, increases the cost[103] of chapter 11 with no corresponding benefit.

b. Informational Impediments to Bargaining

Given that the last class in the money bears all professional costs, one might expect the committee representing that class to negotiate aggressively to keep costs down.[104] There are a number of reasons why that does not occur. At the outset, the parties may not know which class is the last class in the money. Valuation of the debtor is not required, and may change at different points in the case or based on the proposed use of the debtor's assets.[105] Junior classes may perceive that the only road to recovery lies through litigation. Alternatively, where parties overestimate the debtor's value, or that value declines significantly from business losses, a senior class might unexpectedly find itself the last class in the money. Without knowing which party will bear the cost of excessive fees, the parties have no basis for bargaining to control those fees.[106] Even where a committee knows it represents the last class in the

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creditor disputes. Such involvement may be required if the debtor has the exclusive right to file a plan of reorganization.

101. *See* LoPucki & Whitford, *supra* note 10, at 159. Professors LoPucki and Whitford's study found that in every case in which an equity committee was appointed, equity received a share of the estate regardless of how small a distribution was made to unsecured creditors. *Id.* at 190. They propose a "preemptive cramdown" against classes out of the money, to remove those classes from the case. I suggest we simply stop paying their lawyers, except where a class actually obtains a recovery from the estate.

102. The DIP may also incur professional costs, chargeable to the estate, on behalf of these claims or interests. *See id.* at 151.

103. In addition to the fees incurred by the underwater class, more-senior classes incur fees defending these actions. Increased litigation distracting management's attention from the operation of the business, the associated delays, and adverse publicity may also detract from the value of the debtor and thus, be considered costs.

104. The Coase Theorem suggests that if transactions costs are zero, the initial assignment of liability under a rule of law will not affect the efficiency with which resources are allocated, because the parties will bargain to an efficient result. *See* Coase, *supra* note 91. Whatever the merits of the Coase Theorem, the assumptions used by Coase himself suggest that bargaining will not occur here.

105. H.R. REP. NO. 595, *supra* note 21, at 414, *reprinted in* 1978 U.S.C.C.A.N. at 6370; *cf.* 11 U.S.C. § 506(a).

106. The Coase Theorem presupposes that the parties know where the loss will fall under a rule of law. *See* Coase, *supra* note 91. Where the assumptions underlying Coase's model fail, bargaining over the loss may not occur. *Id.* at 16.

money, the transaction costs associated with monitoring[107] professional expenses and the difficulty of negotiating through the very professionals whose costs must be controlled suggest that substantial obstacles to bargaining exist.

c. Agency Costs—Problems with the Representative System

Agency problems created by chapter 11's representative system further complicate cost-containment efforts. The DIP, through its management, acts as trustee for the benefit of all classes of stakeholders. Similarly, official committees act as agents for their constituencies and owe fiduciary duties to the classes of claims or interests represented. As agents, management's or committee members' personal interests sometimes cause them to spend for services principals would not purchase.

Managers may be more interested in job security than in the return to creditors or shareholders. Management that owns the equity may act to preserve ownership interests while risking a return to creditors.[108] Management retains and expands its control through expenditures for professional services. Retention of accountants or financial advisors may improve management's information, and thus its ability to develop a plan of reorganization that keeps management in control. Legal services may extend exclusivity, prevent the appointment of a trustee, or block creditor plans calling for management's removal. Alternatively, management may purchase professional services as a form of insurance against claims they failed to carry out their responsibilities to stakeholders in a reasonably prudent manner.[109] Creditors and shareholders bear the cost of these services while management reaps the benefit. It is not clear whether the Bankruptcy Code should permit management to retain control in light of agency problems.[110] What is clear, is that management's conflict of interest often leads to higher fees.[111]

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107. Absent a pre-service discussion of the legal services to be provided—and there are obvious reasons why parties with opposing interests would not want to disclose their legal strategy to the last class in the money—the costs of monitoring fees may appear excessive in relation to the perceived benefit.

108. See Milton Harris & Artur Raviv, *The Theory of Capital Structure*, 46 J. FIN. 297 (1991) for an overview of the economic literature on this point.

109. Normally, management of a corporation owes "fiduciary" duties to the owners of the business. *See, e.g.*, W. Knepper & D. Bailey, *Liability of Corporate Officers and Directors*, §§ 1.06–1.08 (4th ed. 1988); 18B AM. JUR. 2D *Corporations* § 1684 (1985). In bankruptcy, and under state law where the corporation is insolvent, management may owe fiduciary duties to creditors as well. *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 306–07 (1939) (the fiduciary obligation of a majority shareholder to the corporation is designed for the entire community of interests in the corporation—creditors as well as shareholders); New York Credit Men's Adjustment Bureau v. Weiss, 110 N.E.2d 397, 398 (N.Y. 1953) (officers and directors of an insolvent corporation are considered trustees of the property for the benefit of creditors).

110. *See, e.g.*, Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1045 (1992) (criticizing chapter 11 on the basis, among others, that it encourages management to act in its own self-interest); *cf.* Lynn LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669 (1993) (contending that the Bankruptcy Code and practices in chapter 11 for large companies provide sufficient mechanisms for controlling management's self interest).

111. *See, e.g.*, *In re* Ginji Corp., 117 B.R. 983, 989 (Bankr. D. Nev. 1990) (A debtor may have little concern over fees, as the fees are being paid from assets which would be distributed in any case; and, the beleaguered debtor may not wish to strain his relationship with his life rope, his attorney.); *In re* Great Sweats, Inc., 113 B.R. 240, 242 (Bankr. E.D. Va. 1990) (Court scrutiny of fee applications is necessary, as the DIP has the incentive to stay in

The personal interests of committee members may also lead to decisions to purchase professional services, where the benefit received is not shared by the entire constituency. Committee members might direct professionals to monitor every aspect of the chapter 11 case, even actions with a negligible impact on distributions, to avoid claims that members breached their fiduciary duties.[112] These incentives increase where indenture trustees serve on the committee.[113]

Agency costs are inherent in chapter 11's representational system and cannot be eliminated. At the same time, the lack of information about professional costs and their effect on distributions, permits management and committee members to overspend without accounting for those costs.

The current priority system thus creates three fundamental obstacles to the effective control of professional costs. First, the system provides incentives for senior claims or interests to treat professional fees as externalities, disregarding transaction costs as they negotiate (or litigate) over division of the estate. These incentives to disregard fees translate into incentives to overspend in litigation against the last class in the money, particularly for out-of-the-money classes. Second, the lack of information about who will be required to bear the professional fees prevents the parties from negotiating to limit costs. Third, agency costs compound the problem. The current fee structure gives play to these incentives to increase fees.

### *C. Ex Post—Why Current Regulatory Efforts Do Not Work*

The Bankruptcy Code and Bankruptcy Rules contain a number of provisions designed to check the ability of the DIP and official committees to spend for professional services. A DIP or an official committee must provide notice to parties in interest and seek court approval before retaining professionals.[114] More important, prior to payment of fees from the estate, notice must be given to parties in interest and the U.S. Trustee, and the court must approve the fees.[115] These regulatory mechanisms fail to provide any real control over fees. The structural flaw that creates incentives to overspend also impedes parties from participating in the fee review process. Procedural rules

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business which is often contrary to its obligation to act as a fiduciary for creditors.); *In re* Hamilton Hardware, Inc., 11 B.R. 326, 330 (Bankr. E.D. Mich. 1981) (A debtor has no inclination to object to fees where the attorney made it possible for him to continue in business.).

112. Committee members serve as fiduciaries to the constituencies they represent. *See, e.g., In re* Johns–Manville Corp., 26 B.R. 919, 924 (Bankr. S.D.N.Y. 1983) (it is well established that a holder of a claim or an equity interest who serves on a committee undertakes to act in a fiduciary capacity on behalf of the members of the class he represents); *cf. In re* Microboard Processing, Inc., 95 B.R. 283, 285 (Bankr. D. Conn. 1989) (a committee and its members owe no duty to the debtor or to the estate, but only to the parties or class represented).

113. The indenture trustee, as the representative of public bondholders, has no direct financial stake in the debtor. Instead, the indenture trustee is statutorily charged with the duty to exercise "such of the rights and powers vested in it by [the] indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." 15 U.S.C. § 77ooo(c) (1994). An indenture trustee protects itself from liability for breaches of this duty through expenditures for professional services. By requiring accountants and financial advisors to leave no stone unturned, or requiring committee attorneys to supervise every aspect of the case, an indenture trustee protects itself from liability.

114. *See infra* notes 116–19 and accompanying text.

115. *See infra* notes 127–33 and accompanying text.

further inhibit exercise of that control. The only effective means of controlling professional costs is to correct the incentives to overspend, and to improve information so the market can act to control fees.

*1. Disclosure and Approval of Services and Costs*

The Bankruptcy Code requires both the DIP and official committees to provide notice to parties in interest and seek court approval before retaining professionals.[116] The application must describe the professional services to be provided.[117] This description is frequently a generic list of all services that might conceivably be rendered, to avoid the possibility that, after the issues have crystallized, another party will contest a request to extend the scope of the professional's employment to gain leverage in negotiations or litigation.[118] Applications to retain professionals, particularly counsel and accountants, generally come early in the chapter 11 case when the major issues have not yet been defined. Consequently, they provide no real check on professional fees.[119]

The Bankruptcy Code nominally permits the parties to negotiate with professionals over costs, but takes with one hand what it gave with the other. Section 328 permits retention of professionals "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingency fee basis."[120] Fixed fee or contingency fee arrangements in bankruptcy cases would seem to offer several advantages over an hourly rate

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116. *See* 11 U.S.C. §§ 327(a), 1103(a).

117. Bankruptcy Rule 2014(a), governing the employment of professional persons, provides in relevant part:

> An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee.... *The application shall state the specific facts showing the necessity for the employment*, the name of the person to be employed, the reasons for the selection, *the professional services to be rendered*, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

(emphasis added).

118. Failure to specify the services may lead to disallowance of compensation later if services actually rendered do not fall within the application's scope. *See, e.g., In re* Crown Orthodontic Dental Group, 159 B.R. 307 (Bankr. C.D. Cal. 1993) (Fees for litigation reduced by 50% where attorney never received permission from officers of the corporation to pursue the matter on behalf of the debtors, but relied on the consent of the accountant for the estate.); *In re* Cumberland Farms, Inc., 154 B.R. 9 (Bankr. D. Mass. 1993) (Financial advisor's fees would be disallowed by 10% because the advisor was overly involved in legal issues); *In re* Wang Labs., Inc., 154 B.R. 392 (Bankr. D. Mass. 1993) (Despite committee's instructions that accountants were to conduct an investigation of how debtor's products were used, court denied compensation for these services on the basis that such services were not described in the retention application, and there was no demonstration that the services were required, or that accountants for the committee were the appropriate organization to perform them.).

119. The retention application process plays an important role in screening out attorneys or other professionals who may have a conflict of interest. *See, e.g., In re* Carbide Cutoff, Inc., 703 F.2d 259 (7th Cir. 1983); *In re* Swansea Consol. Resources, Inc., 155 B.R. 28 (Bankr. D.R.I. 1993); *In re* Amdura Corp., 139 B.R. 963 (Bankr. D. Colo. 1992). Where a professional has a conflict of interest, particularly a conflict not disclosed in the retention process, all compensation may be denied. *See Swansea Consol. Resources*, 155 B.R. 28; Jay L. Westbrook, *Fees and Inherent Conflicts of Interest*, 1 AM. BANKR. INST. L. REV. 287 (1993).

120. 11 U.S.C. § 328(a).

structure. Fixed fees let the DIP or committee predict costs with certainty, and require professionals to bear the risk that services will take longer than planned.[121] Contingency fees protect the estate from depletion where the client fails to recover and assure that litigation costs will not consume stakeholders' entire recovery.[122] Hourly rates, on the other hand, create incentives for professionals to run up hours or do too much work in relation to the stakes in the case. Nevertheless, DIPs and committees generally retain counsel on an hourly basis.[123]

Section 328 permits the bankruptcy court to modify fixed or contingency fee arrangements with the advantage of hindsight.[124] This power greatly impairs the ability of DIPs or committees to retain professionals, except on an hourly basis. Professionals retained under a contingency fee run the risk that they will receive nothing. Under both fixed fee and contingency fee arrangements, professionals bear the risk that the engagement will be unprofitable because the engagement requires more work than originally predicted. Basic economics suggests professionals will not accept those risks without receiving a risk premium, i.e., compensation in excess of amounts they would receive if paid on an hourly basis.[125] Section 328(a) authorizes the bankruptcy court to take that risk premium away after the fact, and would seem

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121. Fixed fees, however, also create incentives for the professional to shirk. Consequently, these arrangements may only be suitable where performance is readily defined and easily monitored. *Cf., e.g.*, Kirchoff v. Flynn, 786 F.2d 320 (7th Cir. 1986) (non-bankruptcy case); *In re* Oracle Sec. Litig., 131 F.R.D. 688, 694 (N.D. Cal. 1990) (non-bankruptcy case).

122. Contingency fees, in this respect, align the interests of the professionals and the client. *See Oracle Sec. Litig.*, 131 F.R.D. at 694. The professional bears the risk of no recovery.

123. No reported statistics identify the number or percentage of cases where parties employ professionals on a retainer or contingency fee basis. The ABI Fee Study purported to measure the degree to which professionals utilized the freedom afforded by § 328(a). ABI NATIONAL REPORT, *supra* note 1, at 34. Ambiguities in the questions, however, make the ABI data suspect. The questions asked to lawyers and judges inquired how often contingent fee arrangements had been "authorized." *See id.* at apps. J–63 and L–56. This could be read as asking how often approval of contingency fee arrangements was both sought and given, or how often approved without regard to the frequency of requests. The bulk of reported decisions involve employment of an attorney on an hourly basis, or cases where no method of compensation was specified so that the court had to determine "reasonable compensation" pursuant to 11 U.S.C. § 330. *See, e.g.*, Unsecured Creditors Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955, 960 (9th Cir. 1991).

124. Section 328(a) provides:

> The trustee [which term includes a debtor in possession], 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 section 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, 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) (emphasis added). The emphasized language does not apply to professionals retained on an hourly basis, because even if the court approved an hourly rate, it did not approve the number of hours. *Puget Sound Plywood*, 924 F.2d at 960.

125. Professor Silver has noted, in another context, the adverse effects created when courts do not permit payment of risk premiums to counsel. *See* Charles Silver, *Incoherence and Irrationality in the Law of Attorneys' Fees*, 12 REV. LITIG. 301 (1993); *Control Fees? No, Let the Free Market Do Its Job*, NAT'L L.J., Apr. 18, 1994, at 17.

to impair DIPs' and committees' ability to use alternative fee arrangements to control costs.[126]

*2. Post-Service Review*

The Bankruptcy Code requires the court approve fees before they are paid from the estate.[127] In seeking compensation, a professional must provide a detailed application setting forth the services rendered, the time expended and the expenses incurred, the amounts requested, and the amount of any payments previously made or promised, along with the source of that compensation.[128] Local Rules of Bankruptcy Procedure and guidelines published by the United States Trustee often demand greater detail. Many courts require a separate time entry and detailed description for each service provided, so that the professional must separately record and explain each phone call, letter, or meeting, and each issue researched or pleading drafted.[129] Creditors, or at least some creditors,[130] must receive notice of the fee application.[131]

Stakeholders may object to the allowance of compensation on grounds that the profesional services fail to meet the standard for the award of fees set forth in section 330 of the Bankruptcy Code.[132] That section provides that the bankruptcy court may award to a professional person retained by the DIP or a committee: "(A) reasonable compensation for actual, necessary services rendered by the...professional person, or attorney and by any paraprofessional person employed by any such person; and (B) reimbursement for actual, necessary expenses."[133]

In determining "reasonable compensation" under section 330, the courts

126. Although case law restricts a bankruptcy judge's freedom to void a previously authorized contingency or fee arrangement, the professional adversely affected still must appeal, and could experience substantial delay before payment. Delay has its own costs, and many professionals will not suffer such risks for the premiums offered. *See In re* Reimers, 972 F.2d 1127, 1128 (9th Cir. 1992); *In re* Benassi, 72 B.R. 44, 47 (Bankr. D. Minn. 1987).

127. 11 U.S.C. § 330.

128. FED. R. BANKR. P. 2016.

129. *See, e.g., In re* Jensen–Farley Pictures, Inc., 47 B.R. 557, 583 n.29 (Bankr. D. Utah 1985); *In re* Four Star Terminals, Inc., 42 B.R. 419, 426 n.1 (Bankr. D. Alaska 1984); *In re* Horn & Hardart Baking Co., 30 B.R. 938, 944 (Bankr. E.D. Pa. 1983); *In re* Hamilton Hardware Co., 11 B.R. 326, 330 (Bankr. E.D. Mich. 1981). Particularly in large cases, where professionals provide many services over the course of four months, these requirements lead to voluminous fee applications.

130. Bankruptcy Rule 2002 permits the bankruptcy court to restrict notice of fee matters to relatively few creditors.

131. Despite the level of detail required in fee applications, and that applications are public records, the current regulatory system provides little or no information on total amounts spent in cases or how the compensation awarded compares to the value of distributions to parties in interest. Bankruptcy Rule 2013 requires the clerk to maintain a record of fees awarded in chapter 11 cases, but only for trustees and their professionals, not DIPs or committees. In any event, the data collected under Rule 2013 is not compiled on a national basis. Edward A. Adams, *Billing Rates Higher, Proceedings Take Longer Here*, N.Y.L.J., June 24, 1993, at 1.

132. Prior to the adoption of the Bankruptcy Reform Act of 1994, a long line of authority held that bankruptcy courts had not only the authority, but a duty, to review fees on their own motion. *See infra* note 147. Although the cases suggest bankruptcy courts have an affirmative duty to review fee applications in the absence of objections, it appears that some courts do not review the applications. ABI NATIONAL REPORT, *supra* note 1, § 5.1. The cases finding a "duty" do not identify a mechanism for enforcing this "duty" to act where the parties in interest are silent. The recent amendments make clear that the court may, on its own motion, reduce fees. *See* 11 U.S.C. § 330(a)(2).

133. 11 U.S.C. § 330(a)(1).

generally look to the lodestar analysis adopted by the federal courts in fee-shifting cases.[134] In setting fees under this approach, the court first establishes a "lodestar" amount by multiplying the number of hours reasonably spent by each attorney, by a reasonable hourly rate.[135] The 1994 amendments to the Bankruptcy Code adopt the lodestar approach, and require the court to consider whether the services were necessary to the administration or beneficial to the completion of the case; whether the services were performed within a reasonable amount of time commensurate with the complexity, importance and nature of the problem addressed; and, whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in non-bankruptcy cases.[136] The court must disallow compensation for the unnecessary duplication of services or for services not reasonably likely to benefit the debtor's estate or not necessary to the administration of the case.[137] A bankruptcy court may, on its own motion, review fees in the absence of an objection by a party in interest.[138]

*3. Stakeholder Participation in the Review Process*

The application and review process provides the one real opportunity to

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134. *See, e.g., In re* UNR Indus., Inc., 986 F.2d 207 (7th Cir. 1993); Grant v. George Schumann Tire & Battery Co., 908 F.2d 874 (11th Cir. 1990); *In re* Manoa Fin. Co., 853 F.2d 687, 690 (9th Cir. 1988); Boston & Maine Corp. v. Moore, 776 F.2d 2, 7 (1st Cir. 1985), *but cf. In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 856 (3d Cir. 1994) (noting that lodestar is used because the product of an hourly rate by the number of hours worked is the prevailing billing method in the market for most legal services, but allowing for the use of alternative methods of calculating fees as the market for services evolves). The lodestar method of calculating "reasonable compensation" in cases under the federal fee-shifting statutes is well-established. *See, e.g.*, City of Burlington v. Dague, 112 S. Ct. 2638 (1992); Blanchard v. Bergeron, 489 U.S. 87 (1989); Blum v. Stenson, 465 U.S. 886 (1984); Hensley v. Eckerhart, 461 U.S. 424 (1983).

135. *See, e.g.*, Boston & Maine Corp. v. Moore, 776 F.2d 2, 7 (1st Cir. 1985).

136. Section 330(a)(3)(A), as amended, provides:

> (3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider that nature, the extent and the value of such services, taking into account all relevant factors, including—
> (A) the time spent on such services;
> (B) the rates charged for such services;
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
> (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance and nature of the problem, issue or task addressed; and
> (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

11 U.S.C. § 330(a)(3)(A) (numbering error in the original).

137. Section 330(a)(4)(A) now provides:

> Except as provided in subparagraph (B) [relating to chapter 12 and chapter 13 cases], the court shall not allow compensation for—
> (i) unnecessary duplication of services; or
> (ii) services that were not—
> (I) reasonably likely to benefit the debtor's estate; or
> (II) necessary to the administration of the case.

11 U.S.C. § 330(a)(4)(A).

138. 11 U.S.C. § 330(a)(2). The bankruptcy court's role as controller of fees is discussed in Part II, *infra*.

control professional costs under the current system.[139] One might expect stakeholders, whose money is being spent, to take complaints about high fees to the court. Nevertheless, courts often bemoan the lack of participation in the fee process.[140] Consideration of why various groups of stakeholders fail to act to control fees at this step, provides additional insight to possible reforms.

For the reasons explained above, one might expect representatives of the last class in the money to actively participate in the fee review process because that class gets stuck with the bill. A committee representing the last class in the money has financial incentives to reduce fees, especially bills run up by others. Although costs are spread over a large group and the effect on an individual distribution is small, that effect increases as all professional fees are considered. Similarly, the DIP might be expected to object to fees incurred by official committees. The DIP may use amounts saved to fund its business, or to satisfy stakeholders through larger cash distributions. Both committees and DIPs are well situated to provide meaningful participation in the evaluation of fees. They understand the major issues in the case and can evaluate the relative importance of the issues to the ultimate success of the reorganization.

Notwithstanding the reasons why committees representing the last class in the money or DIPs might actively participate in the ex post facto fee review, they do not.[141] A number of obstacles discourage participation. First, problems in valuing the debtor or unexpected business losses may prevent identification of the last class in the money. More important, the forum for resolution of fee disputes transforms what should be a business judgment into yet another litigation tactic. Currently, parties object to fees by filing a pleading with the court. At its heart, an objection contends that another party made unreasonable decisions about how to move the case towards confirmation of a plan of reorganization. Submission of such a document during negotiations, in a public record available to the press, often proves counterproductive. As one bankruptcy attorney commented, "Attacking a fee application can be a bit of an atom bomb, when you want a low caliber pistol."[142]

Concerns about retaliation may also affect the parties' willingness to object. A few courts attribute the lack of objections to "a conspiracy of silence" among professionals requesting compensation from the estate.[143] Despite courts'

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139. Costs might be controlled if clients carefully considered costs before requesting professional services. As noted above, however, clients have little incentive to do so.

140. *See, e.g., In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 842 (3d Cir. 1994) (at least before some benches, objections to fee applications are relatively uncommon); *In re* Columbus Mortgage & Loan Corp., 155 B.R. 297, 298 (Bankr. D.R.I. 1993) (at fee hearings all of the professionals are represented fully as to their applications, while the interest of general or unsecured creditors paying the fees is essentially unrepresented); *In re* Pettibone Corp., 74 B.R 293, 300 (Bankr. N.D. Ill. 1987) (Because objections to fees are presented so rarely in bankruptcy, the court's role in the review of fees is critical.); *In re* Liberal Mkt., Inc., 24 B.R. 653, 657 (Bankr. S.D. Ohio 1982) (fees are often asserted against a bankruptcy estate without any adverse interest appearing at the hearing).

141. *See supra* note 140; *but cf.* ABI NATIONAL REPORT, *supra* note 1, at 56. The ABI National Report indicates that 82% of the judges surveyed indicated that objections to fees were filed in 10% or more of their chapter 11 cases. *Id.* at 56. This statistic would appear to include "objections" made by the judges themselves. *See id.* at app. J–20.

142. Robert Levine, partner at Davis Polk & Wardwell, quoted in Barbara Franklin, *Passing Fee Inspection: Bankruptcy Bar Adjusts to Plans to Reduce Costs*, N.Y.L.J., May 14, 1992, at 5.

143. *See In re* Consolidated Bancshares, Inc., 785 F.2d 1249, 1255 (5th Cir. 1986) (Too

suggestions that professionals' sinister motives lead to the lack of objections, disincentives on the part of clients provide an equally plausible explanation.[144] Committees and DIPs may, themselves, be concerned that retaliatory objections will deprive them of the data or representation needed to carry out their respective functions. Whatever the reason, it is clear that committees and DIPs frequently do not oppose requests for professional fees.

The same problem that discourages individual stakeholders from participating in the chapter 11 case generally—the costs involved often exceed any increase in recovery—also discourages objections to fees.[145] Further, individual stakeholders generally do not receive notice of requests for professional fees.[146]

Thus it is apparent that clients, under the current system, are unlikely to gain control over professional costs in bankruptcy. Because of the lack of stakeholder participation, the system has adopted administrative controls—independent review by bankruptcy courts or review by the U.S. Trustee—to fill the gap. Part II examines the effectiveness and advisability of these administrative controls.

## II. ADMINISTRATIVE REGULATION OF COSTS

Bankruptcy judges frequently take an active role in fee matters. A long line of authority, now codified, holds that the bankruptcy court has not only the

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frequently counsel for the DIP and official committees, "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. (One bankruptcy judge characterized this process as a 'massive backscratching exercise.')"); *In re* Hamilton Hardware, Inc., 11 B.R. 326, 330 (Bankr. E.D. Mich. 1981) (Attorneys for the committee know voiced objections invite retaliation and therefore acquiesce even if the fees are unreasonable.). Other courts note that attorneys' willingness to actively object to the fees of other professionals may be tempered by the fact that they too will seek compensation from the estate. *See In re* Ginji Corp., 117 B.R. 983, 989 (Bankr. D. Nev. 1990) (opposition from others may be tempered by the fact that they too expect to be paid from the estate); *In re* Jensen–Farley Pictures, Inc., 47 B.R. 557, 585 n.39 (Bankr. D. Utah 1985) (Objections to fee requests often invite retaliation.); *In re* Underground Utils. Constr. Co., 13 B.R. 735, 736 (Bankr. S.D. Fla. 1981) (attorneys have traditionally been reluctant to question another attorney's fee application).

144. I am reluctant, in the absence of hard data, to accept the courts' seeming assertions that the bulk of professionals involved in reorganizations routinely ignore their fiduciary responsibilities, and pursue their own interest at the expense of the client, and in the face of protests by the client.

145. *See, e.g.*, *In re* Great Sweats, Inc., 113 B.R. 240, 242 (Bankr. E.D. Va. 1990) (court's responsibility to review fees is great as each creditor individually has little reason to object to the requested compensation due to the costs incidental to the objection when compared to the possible amount of recovery from the estate); *In re* Hamilton Hardware, Inc., 11 B.R. 326, 330 (Bankr. E.D. Mich. 1981) (creditors without lawyers are unable to lodge effective objections); *In re* Goldenberg, 2 F. Supp. 727, 727 (E.D. Pa. 1933) ("Bankruptcy law and the [predecessors of the Bankruptcy Rules] give the creditors adequate machinery to resist exaction by attorneys. Theoretically, they should be able to protect themselves. Practically, they are usually helpless. The amount to be gained by any individual creditor is so small that it is rarely worth his while to undertake the defense of the estate against unwarranted charges.").

146. Ironically, courts lamenting the absence of creditor objections fail to consider how their adoption of limited notice procedures leads to that absence. In chapter 11 cases, the court may order that notices of fee requests be mailed only to the U.S. Trustee, official committees or their authorized agents, and to stakeholders who request notice. FED. R. BANKR. P. 2002(i). While limited notice procedures may result in substantial savings, they also substantially decrease the number of stakeholders who have the opportunity to submit objections to professional fees.

power, but a duty, to review fees, notwithstanding the absence of objections by parties in interest.[147] The only contrary line of authority was overruled by the Third Circuit in 1994.[148] The emphasis on court review follows in the tradition of the Bankruptcy Act and prior laws by using tighter court control to redress complaints over high administrative costs.[149] Courts attempt to justify the tradition by pointing to the lack of creditor participation in fee matters, and suggesting that court review is necessary to protect the integrity of the courts.

However useful court review may be as a stop-gap measure under the current system, reliance on *sua sponte* court review to control fees should be abandoned. First, the conceptual foundations of court review lack coherence. Second, by its very nature, the ex post facto review of fees adds costs to the system. Third, the claimed justifications for court review, the lack of creditor participation and the "public interest" in fees, do not hold up under scrutiny. Finally, court review of fees does not work. By claiming responsibility for fees under a system that does not and cannot work, the court calls its integrity into question.

### *A. Court Participation Under the Current System*

The Bankruptcy Code requires that the court approve fees prior to payment from the estate.[150] A professional seeking compensation, files a detailed application, which the court then reviews to assure that the services meet the standard for allowance of fees.[151] The court must consider whether the services were necessary to the administration or beneficial to the completion of the case; whether the services were performed within a reasonable amount of time; and, whether the compensation is reasonable based on fees charged for comparable services in non-bankruptcy cases.[152] The court must disallow

147. *See* 11 U.S.C. § 330(a), and *see, e.g.*, *In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 841 (3d Cir. 1994); *In re* Kitchen Lady, Inc., 144 B.R. 544, 546 (Bankr. M.D. Fla. 1992); *In re* Paul, 141 B.R. 299, 301 (Bankr. E.D. Pa. 1992); *In re* Cascade Oil Co., 126 B.R. 99, 106 (Bankr. D. Kan. 1991); *In re* Sounds Distrib. Corp., 122 B.R. 952, 957 (Bankr. W.D. Pa. 1991); *In re* Saunders, 124 B.R. 234, 236 (Bankr. W.D. Texas 1991); *In re* Montgomery Drilling Co., 121 B.R. 32, 35 (Bankr. E.D. Cal. 1990); *In re* Pettibone Corp., 74 B.R. 293, 300 (Bankr. N.D. Ill. 1987); *In re* Seneca Oil Co., 65 B.R. 902, 908 (Bankr. W.D. Okla. 1986); *In re* Holthoff, 55 B.R. 36, 39 (Bankr. E.D. Ark. 1985); *In re* Stable Mews Assocs., 49 B.R. 395, 398 (Bankr. S.D.N.Y. 1985); *In re* Daylight Transp., Inc., 42 B.R. 20, 26 (Bankr. E.D.N.Y. 1984); *In re* Watson Seafood & Poultry Co., 40 B.R. 436, 438 (Bankr. E.D.N.C. 1984); *In re* Crutcher Transfer Line, Inc., 20 B.R. 705, 710 (Bankr. W.D. Ky. 1982); *In re* Liberal Mkt., Inc., 24 B.R. 653, 657 (Bankr. S.D. Ohio 1982); *In re* Hamilton Hardware Co., 11 B.R. 326, 329 (Bankr. E.D. Mich. 1981).

148. *In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 841 (3d Cir. 1994), overruling *In re* Jensen's Interiors, Inc., 132 B.R. 105, 106 (Bankr. E.D. Pa. 1991) (bankruptcy court cannot reduce attorneys fees *sua sponte*); *In re* Delaware River Stevedores, Inc., 147 B.R. 864, 868–70 (Bankr. E.D. Pa. 1992); *In re* Rheam, Inc., 142 B.R. 698, 700 (Bankr. E.D. Pa. 1992) (bankruptcy court's discretion to deny fees is limited when the application is unopposed); *In re* T&D Tool, Inc., 132 B.R. 525, 526, 528 n.1 (Bankr. E.D. Pa. 1991).

149. COLLIER 14th ed., *supra* note 11, ¶ 62.02[1]:

> Complaints about unnecessarily high expenditures attendant upon liquidation proceedings are common in the history of American bankruptcy law. There is practically no period in the development of the institution at which such complaints were not expressed, resulting often in the enactment of provisions intended to increase and strengthen judicial control over expenses of administration.

150. *See* 11 U.S.C. § 330(a)(2).

151. *See supra* notes 133–37 and accompanying text.

152. 11 U.S.C. § 330(a)(3)(A), and *see supra* note 136 and accompanying text.

compensation for services not reasonably likely to benefit the debtor's estate or not necessary to the administration of the case.[153]

Although the rules for fee allowance sound straightforward, courts struggle to apply them in practice. The more than 300 reported fee decisions provide testimony of that struggle. Bankruptcy courts are not alone. In fee shifting and common fund cases, federal district courts also grapple with the difficulty of determining a reasonable fee.[154] Scholars have also wrestled with developing a suitable theory on which workable compensation standards might be based.[155] This article does not attempt to resolve those problems, but suggests that, at least in bankruptcy, a better alternative exists.

### *B. The Conceptual Foundation of Court Review*

It has often been suggested that in determining the "reasonableness" of fees, the court acts as a substitute for market forces, and must assure the estate receives quantum meruit—the benefit paid for.[156] Courts sometimes reduce fee requests as "unreasonable" where the professionals spent too much time in light of the expected benefit.[157] Courts may also find certain services not "necessary" where the professionals for the DIP spent "excessive" time on behalf of a class whose interests were underwater.[158] The 1994 amendments apparently codify

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153. 11 U.S.C. § 330(a)(4)(A). *See supra* note 137.

154. *See, e.g.*, Alan J. Homkins & Thomas E. Willging, *Taxation of Attorneys' Fees: Practices in English, Alaskan and Federal Courts* (Federal Judicial Center 1986); Thomas E. Willging, *Judicial Regulation of Attorneys' Fees: Beginning the Process at Pretrial* (Federal Judicial Center 1984).

155. *See, e.g.*, Samuel R. Berger, *Court Awarded Attorneys' Fees: What is Reasonable?*, 126 U. PA. L. REV. 281 (1977); John P. Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation*, 88 HARV. L. REV. 849 (1975); John P. Dawson, *Lawyers and Involuntary Clients: Attorney Fees From Funds*, 87 HARV. L. REV. 1597 (1974); John Leubsdorf, *The Contingency Factor in Attorney Fee Awards*, 90 YALE L.J. 473 (1981); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiff's Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 48–61, 105–116 (1991); Charles Silver, *Unloading the Lodestar: Toward a New Fee Award Procedure*, 70 TEX. L. REV. 865 (1992).

156. *See, e.g., In re* Farley, Inc., 156 B.R. 193, 210 (Bankr. N.D. Ill. 1993) (In a true market, demand for legal services arises out of clients who have weighed the costs and benefits of retaining counsel, and who expect to pay the costs. A court may determine the market value of services in bankruptcy by ascertaining whether actual market forces and procedures are at work.); *In re* Bank of New England Corp., 134 B.R. 450 (Bankr. D. Mass. 1991), *aff'd*, 142 B.R. 584 (Bankr. D. Mass. 1992) (the court must assure that a DIP or trustee retaining professionals acts as would "a well informed private client, paying his own fees"); *In re* Liberal Mkt., Inc., 24 B.R. 653, 658 (Bankr. S.D. Ohio 1982) (the basic purpose of court inquiry is to inject quantum meruit concerns because of the absence of a "bargaining process" in the calculation of fees charged against the estate).

157. *See* Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955, 959 (9th Cir. 1991) (in awarding fees, the court must make a cost-benefit analysis, considering: (a) whether the burden of the probable cost of legal services is disproportionately large in relation to the size of the estate and the maximum probable recovery; (b) the extent to which the estate will suffer if the services are not rendered; and (c) the extent to which the estate may benefit if the services are rendered and the likelihood of the disputed issues being resolved successfully); *In re* Hutter Constr. Co., Inc., 126 B.R. 1005, 1012 (Bankr. E.D. Wis. 1991) (same); *but cf. In re* Gilead Baptist Church, 135 B.R. 38 (Bankr. E.D. Mich. 1991) (Under present law, given the size of the case, fees must be reduced to obtain a reasonable proportion between the benefit to the creditors and the costs associated with that benefit), *rev'd without published opinion*, 806 F. Supp. 644 (E.D. Mich. 1991).

158. *See In re* Lederman Enters., Inc., 997 F.2d 1321 (10th Cir. 1993); *In re* Office Prods. of Am., Inc., 136 B.R. 983, 991 (Bankr. W.D. Texas 1992). For an excellent

these results.

The "reasonable compensation" standard, when juxtaposed against a system where managers, one or more classes of creditors, and equity holders are all competing for the same assets, loses coherence. From whose perspective should the court judge reasonableness? The client or the party who pays? Should the court defer to the client's business judgment as to the reasonableness,[159] or review fees "de novo"? If review is de novo, how should the court weigh costs to the last class in the money against benefit to other classes? Should the court consider external factors that make preservation of a full recovery particularly important to a creditor or class of senior creditors?[160] These analytical difficulties arise from the separation of costs and benefits in allocating professional costs. They could be eliminated or reduced by making each group pay for its own services, and letting a real market, rather than a substitute, control the purchase of services.

Implicit in court review, and the perceived need for court review, is the conclusion that the bankruptcy court measures the "reasonableness" of professional costs differently than did the clients when they requested the services. The belief that independent court review of fees is essential[161] suggests clients frequently direct professionals to provide services that the estate should not be required to pay for. Although court review of fees protects the estate from the direct cost of such fees, the after-the-fact disallowance imposes its own costs on the chapter 11 system.

### *C. Increased Costs from Court Review*

Disallowance of professional fees does not protect the estate from all of the costs arising from that litigation, nor does it check the incentives for over-litigation in the first instance. If a DIP or committee incurs costs beyond the probable benefit of litigation, the court remedies the problem by disallowing compensation to that party's professional. Those fees, however, represent only one small part of the costs incurred by the estate when the parties litigate. Other parties may incur professional fees in responding to that litigation.[162] Such litigation may also delay development and confirmation of a chapter 11 plan or affect the debtor's business prospects if customers, suppliers and prospective lenders perceive the company as mired in chapter 11.

Disallowance of fees after a professional renders services may penalize professionals who act diligently and in good faith at the direction of their

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discussion of these cases and the problems of denying compensation to counsel for the DIP based on the inherent conflicts of a representative that owes fiduciary duties both to creditors and shareholders, see Westbrook, *supra* note 119.

159. One would hope that the DIP or committee made this determination at the time of requesting the services, and again prior to the professional's submission of the application for fees.

160. For example, the senior unsecured creditors might need to assure full recovery to avoid default on other obligations, to avoid regulatory problems, or because they want to show a good return to their investors.

161. The National Bankruptcy Conference apparently suggests that court review is necessary. *See* REFORMING THE BANKRUPTCY CODE, *supra* note 12, at 301. I disagree. With the changes discussed in Part II, independent court review of fees could be eliminated. I would retain a role for the court in adjudicating fee disputes in cases where a party in interest objects.

162. Although the court may deny fees incurred by the party pursuing the litigation, the justification for denying fees to parties forced to respond to an unreasonable action is less clear.

clients, and ultimately increase the cost of retaining qualified professionals. Court review of fees comes after the professional performs the work and incurs costs for employees, rent and other overhead. Only after the fact does a party in interest or the court contend that the services directed by the client were not "necessary," the hourly rate too high,[163] or that expenses normally charged as separate items should be "overhead."[164]

The "bankruptcy haircut" leads to strategic behavior by professionals. All professionals who charge on an hourly basis routinely make adjustments for time inefficiently or unproductively spent. If bankruptcy regularly results in disallowance of a larger portion of the time spent,[165] that loss must be recouped. Professionals will increase rates to compensate for the risk of nonpayment or, alternatively, make no adjustment for time inefficiently spent, leaving the court to trim fees.[166] In cases where courts do not disallow those increased fees, estates pay more. If courts respond with larger cuts in fees, professionals bill at higher rates or for excessive hours yet again, creating a vicious cycle.[167] If professionals cannot recoup losses effected by the "bankruptcy haircut" through work in bankruptcy cases, the only alternative is to seek nonbankruptcy work.[168]

Disallowance protects the last class in the money, but requires the professional to bear the burden of a client's "bad" decision. Some might see this as a good thing. The specter of disallowance might prompt attorneys and other professionals to discourage clients from pursuing wasteful litigation.[169] This

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163. *See, e.g., In re* Durbin Paper Co., 169 B.R. 115, 122 (Bankr. E.D. Pa. 1994) (attorneys entitled to interim fees at hourly rates ranging from $200 to $250 per hour instead of the requested rates ranging from $220 to $325 per hour).

164. *See, e.g., In re* 321 S. Main St., L.P., 155 B.R. 41, 43 (Bankr. D.R.I. 1993) (overtime, document preparation and word processing fall within the category of "overhead" which is included in the professional's hourly rate and therefore not compensable as a separate expense). While this case, and other cases like it, arise out of a natural instinct to protect against professionals nickel and dime-ing clients to death, the logic is faulty. In setting the rates and fees charged to clients, and determining their expected revenues, professionals expect to cover their costs and make a profit. They might decide to keep fees lower, and recoup an increase in costs by charging clients directly for variable expenses. In that circumstance, the variable charges would not be covered in the "overhead" of the professional's hourly rate. *See, e.g., In re* Mulberry Phosphates, Inc., 169 B.R. 750, 752 (Bankr. M.D. Fla. 1994).

165. Bankruptcy will regularly result in professionals taking a "haircut," since the court often makes different judgments about fees than does the client directing services.

166. *Cf. In re* Atwell, 148 B.R. 483 (Bankr. W.D. Ky. 1993); *In re* Associated Grocers, Inc., 136 B.R. 413, 421 (Bankr. D. Colo. 1990); *In re* Great Sweats, Inc., 113 B.R. 240, 242 (Bankr. E.D. Va. 1990).

167. Professionals' strategic behavior might be viewed as evidence of nefarious motives. Professionals, however, have rent, taxes and other overhead which must be covered by revenues if they are to remain in business. Despite attorneys' current unpopularity, they are entitled to make a profit.

168. The concern that able practitioners would be forced away from bankruptcy practice led to the liberalization of the compensation standards under the Bankruptcy Reform Act of 1978. *See* H.R. REP. No. 595, *supra* note 21, at 330, *reprinted in* 1978 U.S.C.C.A.N. at 6286.

169. *Cf., e.g., In re* Taxman Clothing, Co., 49 F.3d 310, 315 (7th Cir. 1995) (attorney had duty to drop a suit as soon as it became clear that suit could not yield the estate a net gain); Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955, 958–59 (9th Cir. 1991) (A professional may not "run up a tab without considering the maximum possible recovery."); *In re* Hutter Constr. Co., 126 B.R. 1005, 1012 (Bankr. E.D. Wis. 1991); *see also In re* Hunt, 124 B.R. 263, 267 (Bankr. S.D. Ohio 1990). These cases suggest the *professional* (rather than the client) must weigh the probable costs and benefits before providing services.

approach, however, pushes onto professionals business decisions that are best left to clients,[170] and leads to more, not less, control of the process by professionals.[171]

### *D. The Traditional Justifications for Court Control*

Courts frequently cite the lack of participation by clients, creditors and other parties in interest, and the inability of creditors and debtors to protect themselves from avaricious professionals, to justify *sua sponte* review of fees.[172] In most chapter 11 cases, the bulk of creditors will be financially sophisticated parties or entities who regularly engage in the extension of credit to businesses. These parties are not the sort generally considered to need protection in financial dealings. The suggestion that courts must control fees because no one else will provides only the flimsiest justification for court control. If court concerns about overspending arise out of the bizarre incentives identified in Part I, the solution is to correct the incentives. Why should the court be concerned where the parties paying the bill do not care enough to object?

Alternatively, courts justify the *sua sponte* review of fees as necessary to protect the integrity of the court, to preserve public perceptions of the fairness of the bankruptcy process, and to serve the "public interest" in fees.[173] The view is a carry-over from practice under the Bankruptcy Act,[174] where the

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170. Requiring attorneys to determine whether to pursue litigation in light of the perceived costs and benefits runs afoul of ethical standards which leave decisions on whether to pursue non-frivolous litigation, or to assert a defense, to the client and not the lawyer. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-7 (1995) ("the authority to make decisions is exclusively that of the client and, if made within the framework of the law, such decisions are binding on his lawyer"); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1995) ("A lawyer shall abide by a client's decisions concerning the objectives of representation...and shall consult with the client as to the means by which they are to be pursued"). The Comment to Rule 1.2(a) adds: "In questions of means, the lawyer should assume responsibility for technical and legal tactical issues, but *should defer to the client regarding such questions as the expense to be incurred* and concern for third persons who might be adversely affected." (Emphasis added).

171. *Cf.* H.R. REP. NO. 595, *supra* note 21, at 92, *reprinted in* 1978 U.S.C.C.A.N. at 6053 (discussing at length the dangers and problems created when professionals control bankruptcy cases).

172. *See supra* note 140.

173. *See, e.g., In re* Evans, 153 B.R. 960, 968 (Bankr. E.D. Pa. 1993) ("We continue to believe that no less than the integrity of the bankruptcy system and, ultimately, the entire court system, is at stake in the issue of a bankruptcy judge's performance of the duty to review fee applications *sua sponte*."); *In re* Gulf Consol. Servs., Inc., 91 B.R. 414, 420 (Bankr. S.D. Tex. 1988) ("public interest still plays a part in a determination of fee awards in bankruptcy cases, if not from the view point of 'economy of the estate,' then at least inherently from the standpoint of the Code's requirements for court supervision of fees and the public's perception of the integrity and fairness of our bankruptcy system and courts"); *In re* Wildman, 72 B.R. 700 (Bankr. N.D. Ill. 1987) (the bankruptcy court sits as guardian of the funds available to creditors and is charged with the responsibility for reviewing fees because it alone can act as a disinterested arbiter); *In re* Daylight Transp., Inc., 42 B.R. 20, 21 (Bankr. E.D.N.Y. 1984) (court supervision of fees is essential to the operation of the bankruptcy laws and integral to the bankruptcy system).

174. A long line of cases under the Bankruptcy Act held the bankruptcy court had an independent duty to review fees for reasonableness, pointing to a "public interest" in fee awards, or a link between fees awarded out of an estate and the public's perception of the court. *See, e.g.*, Leiman v. Guttman, 336 U.S. 1 (1949); Dickinson Indus. Site, Inc. v. Cowan, 309 U.S. 382 (1940); York Int'l Bldg. Inc. v. Chaney (*In re* York Int'l. Bldg. Inc.), 527 F.2d 1061, 1068 (9th Cir. 1976); Massachusetts Mut. Life Ins. Co. v. Brock, 405 F.2d 429 (5th Cir. 1969); Official Creditors' Comm. of Fox Mkts., Inc. v. Ely, 337 F.2d 461, 465 (9th Cir.

structure for hiring and supervising professionals was substantially different from the current system. Under the Act, the bankruptcy judge appointed the trustee or receiver, who in turn selected the attorneys and other professionals.[175] Bankruptcy courts under the Act could, and sometimes did, operate as an old fashioned patronage system.[176] Considered in this light, statements that "attorneys assisting the trustee in the administration of the estate are acting not as private persons, but as officers of the court,"[177] or "fixing of counsel fees is an attribute of the court's 'exclusive and non-delegable control over the administration of an estate,'"[178] and references to a "public interest" in fees, take on a different meaning. Under the old system, cases where fees to the bankruptcy judge[179] and his appointees consumed the entire estate naturally cast doubt on the system's fairness, and strict control of fees was essential to the court's integrity.

The Bankruptcy Reform Act of 1978 effected a significant change in the responsibilities and role of the bankruptcy court.[180] Bankruptcy courts no longer direct disposition of the debtor's assets, or appoint acquaintances to take control and collect fees from the estate, but instead act as arbiters of disputes.[181] Under this system, allowance of fees (even excessive fees) does not indict the

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1964); *In re* Detroit Int'l Bridge Co., 111 F.2d 235, 238 (6th Cir. 1940); *In re* Dole Co., 244 F. Supp. 751, 754 (D. Me. 1965); *In re* Goldenberg, 2 F. Supp. 727 (E.D. Pa. 1933); *In re* Metallic Specialty Mfg. Co., 215 Fed. 937 (D. Pa. 1914). Many of the early cases under the Bankruptcy Code cited to Act cases as authority for the proposition that the bankruptcy court has an independent duty to review fees for reasonableness. *See, e.g., In re* Nor-Les Sales, Inc., 32 B.R. 900 (Bankr. E.D. Mich. 1983); *In re* Crutcher Transfer Line, Inc., 20 B.R. 705 (Bankr. W.D. Ky. 1982); *In re* Best Pack Seafood, Inc., 21 B.R. 852 (Bankr. D. Me. 1982); *In re* Darke, 18 B.R. 510 (Bankr. E.D. Mich. 1982); *In re* Hamilton Hardware Co., 11 B.R. 326, 329 (Bankr. E.D. Mich. 1981). Other courts, although not citing to the Act cases, cite to the Code cases that cite the Act cases. *See, e.g.*, Boston & Maine Corp. v. Moore, 776 F.2d 2 (1st Cir. 1985); *In re* Caribou Partnership III, 152 B.R. 733 (Bankr. N.D. Ind. 1993); *In re* Mayes, 101 B.R. 494 (Bankr. W.D. Mich. 1988); *In re* STN Enter., Inc., 70 B.R. 823 (Bankr. D. Vt. 1987); *In re* Jensen-Farley Pictures, Inc., 47 B.R. 557 (Bankr. D. Utah 1985); *In re* B&W Tractor Co., 38 B.R. 613 (Bankr. E.D.N.C. 1984); *In re* Watson Seafood & Poultry Co., 40 B.R. 436 (Bankr. E.D.N.C. 1984); *In re* Garnas, 40 B.R. 140 (Bankr. D.N.D. 1984); *In re* Int'l Coins & Currency, Inc., 26 B.R. 256 (Bankr. D. Vt. 1982).

175. *See supra* note 22.

176. H.R. REP. NO. 595, *supra* note 21, at 92, *reprinted in* 1978 U.S.C.C.A.N. at 6053.

177. Official Creditors' Comm. of Fox Mkts., Inc. v. Ely, 337 F.2d 461, 465 (9th Cir. 1964).

178. *In re* Penn Fruit Co., 26 B.R. 81, 84 (Bankr. E.D. Pa. 1982) (ruling on fees in a Chapter XI proceeding).

179. Originally, referees received compensation from fees charged to bankruptcy estates. Referees were moved to a salary system in 1946. See discussion in COLLIER 14th ed., *supra* note 11, ¶ 62.06.

180. The Bankruptcy Reform Act of 1978 separated the administrative and adjudicative functions of the old bankruptcy referees. Under the new system, bankruptcy courts exercise the adjudicative, but not the administrative, functions. *See* H.R. REP. NO. 595, *supra* note 21, at 107–08, *reprinted in* 1978 U.S.C.C.A.N. at 6068–69; and COMM'N REP., *supra* note 21, pt. I, at 237. The later amendments to the Bankruptcy Reform Act, including the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 353, 98th Cong., 2d Sess. (1984), did not change this bifurcation between the administrative tasks and the adjudicative functions. With the adoption of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 554, 99th Cong., 2d Sess. (1986), the United States Trustee system, which supervises the administration of bankruptcy cases, became permanent, leaving to the bankruptcy court the adjudicative functions.

181. H.R. REP. NO. 595, *supra* note 21, at 107, *reprinted in* 1978 U.S.C.C.A.N. at 6068–69; and COMM'N REP., *supra* note 21, at pt. I, at 237.

integrity of the court or affect the public interest.[182] *Sua sponte* review of fees is an outmoded relic from the past.

Nor can justification for independent court review be found in the judiciary's inherent power to supervise attorneys[183] that practice before them.[184] Generally, the court's supervisory power over attorneys' fees in matters before the court derives from the court's special role as protector of vulnerable clients against the excesses of their lawyers, and as the primary regulator of the legal profession.[185] This supervisory power is exercised in actions involving the estates of minors and incompetents, wrongful death actions, actions involving seamen, and class actions.[186] These situations are factually distinct from most chapter 11 cases.[187] Unlike minors, incompetents or seamen, creditors in bankruptcy cases do not operate under a legal disability. Nor is the bankruptcy court's process used to create a "fund in court" that did not previously exist.[188] Courts, in their role as primary regulator of the legal profession, sometimes review fees to determine whether they are "excessive," particularly under contingency fee contracts or where an attorney brings an action against a client.[189] The bankruptcy court does not limit its review to determining whether fees are clearly excessive.[190] Finally, the authority of bankruptcy courts, as Article I courts, to exercise the Federal courts' regulatory power over attorneys is in doubt.[191]

### *E. Fee Review and the Bankruptcy Court's Integrity*

Despite the shortcomings of after-the-fact review, the bankruptcy system has a long tradition of court control over professional fees; a tradition that some may be reluctant to abandon. Control over fees is control over professionals. Courts can use their control over fees to discipline recalcitrant, ill-prepared, or negligent professionals.[192] Courts might also use this power to

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182. *But cf. infra* note 259 and accompanying text.

183. This power could not justify, in any event, the court's regulation of accountants, financial advisors, or other non-legal professionals.

184. At least one court has cited the power of courts over fees in "fund in court" cases as justification for *sua sponte* court review of fees in bankruptcy cases. *See In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 841 (3d Cir. 1994).

185. GEOFFREY C. HAZARD ET AL., THE LAW AND ETHICS OF LAWYERING 515–25 (2d ed. 1994); CHARLES WOLFRAM, MODERN LEGAL ETHICS 496 (1986).

186. WOLFRAM, *supra* note 185, at 498.

187. Chapter 7 cases and other cases where the United States Trustee appoints a trustee to manage the estate present problems different from those in most chapter 11 cases. In those circumstances the court—or better yet, the United States Trustee—may need to play an active role in controlling costs. I suggest a simple and workable solution below. *See infra* notes 257–58 and accompanying text.

188. In wrongful death actions, class actions, or other "fund in court" cases, attorneys use the court's process to create a "fund" that did not previously exist, raising concerns about barratry and champerty, and the integrity of the court's process. In bankruptcy cases, the fund (the debtor's estate) already existed, and the petition for relief under the Bankruptcy Code merely shifted the forum and the rules for administering that fund. Outside of bankruptcy, creditors pursue collection actions against the debtor's assets in state court, recovering on a first-come, first-served basis.

189. WOLFRAM, *supra* note 185, at 498–500.

190. Bankruptcy courts at times discuss whether copying costs are recoverable. *See, e.g., In re* New Hampshire Elec. Coop., Inc., 146 B.R. 890 (Bankr. D.N.H. 1992). Copying costs, however large, cannot make the difference between a "reasonable" fee and an "excessive" fee.

191. *Cf.* Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982).

192. Bankruptcy specialists cannot generally avoid this control, even if their fees in a

discipline professionals who appeal the court's rulings, actively oppose the debtor, or otherwise take action inconsistent with the court's view of what should be done in the chapter 11 case. Some courts will not want to cede this power. However, in denying payment for professional costs associated with a DIP's or committee's preferred course of action, the court second-guesses whether the DIP or committee properly undertook litigation, an appeal of the court's ruling, or development of an alternate plan of reorganization. While most courts presumably act with the utmost integrity, the disallowance of fees may lead to the appearance of bias or suggest retaliation. The Bankruptcy Reform Act of 1978 sought to curtail court involvement in these types of decisions, because that involvement seriously compromised the judge's impartiality as an arbiter of disputes.

Court review does not work. Clinging to the remnants of a failed system affects public perceptions of the courts' fairness and effectiveness. Bankruptcy courts claim responsibility for protecting the estate against the depredations of professionals, a responsibility left to clients in most other contexts. If parties in bankruptcy cases believe that the court must control fees (and the court says it must), then excessive fees are cast as a failing of the court, rather than of the parties that hire and direct the services of those professionals. Perhaps the solution here is for courts to stop claiming the responsibility for controlling fees.

Court review cannot effectively or efficiently control fees. In large cases, reviewing fees and poring over hundreds of pages in time records, consumes significant amounts of scarce judicial resources;[193] resources that might better be spent on moving cases toward a plan and completion. *Sua sponte* review further creates potential due process problems,[194] and requires appellate courts to rule on appeals where no adverse party appears.[195] The current system's reliance on court review is a relic from the past, and should be discarded. Instead, reform efforts should focus on correcting the economic incentives that lead to overspending.

### *F. U.S. Trustee Participation in Fee Regulation*

The United States Trustee Program, a division of the Department of

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particular case do not come from the estate. Specialists frequently will come before a court in more than one bankruptcy case.

193. The time and resources required to review fee applications have led some courts to appoint fee examiners, despite the extra layer of costs involved. *See, e.g., In re* Continental Airlines, Inc., 138 B.R. 439 (Bankr. D. Del. 1992).

194. Due process problems arise where the court disallows fees without providing the professional an opportunity to respond to the court's objections. *See In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 846 (3d Cir. 1994) (if fees of a good faith applicant are disallowed, the Code and the dictates of due process mandate that the applicant be provided an opportunity to present evidence or argument); *In re* Beverley Mfg. Corp., 841 F.2d 365 (11th Cir. 1988) (evidentiary hearing may be required when court *sua sponte* denies fees); *In re* Bank of New England Corp., 142 B.R. 584, 588 (Bankr. D. Mass. 1992) (initial fee application must be sufficient to satisfy applicant's burden of proof, so that applicant is not entitled to reconsideration where it could have presented evidence at time of application); *In re* Paul, 141 B.R. 299, 301 (Bankr. E.D. Pa. 1992) (if the court has concerns about the amount of fees sought or the hours or nature of the work performed the court must hold a hearing); *but cf. In re* Pothoven, 84 B.R. 579, 583 (Bankr. S.D. Iowa 1988) (*sua sponte* reduction of fees by court without allowing presentation of evidence by attorney is not a denial of due process).

195. *See In re* Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 837 n.1 (3d Cir. 1994).

Justice responsible for supervising cases filed under chapters 7, 11 or 13 of the Bankruptcy Code and monitoring requests for professional compensation,[196] in recent years has been taking a more active role in the fee review process. Prior to 1994, the U.S. Trustees in a number of districts published fee guidelines describing the types of services to which the U.S. Trustee will likely object and the types of information that must be disclosed.[197] The 1994 Amendments to the Bankruptcy Code require the Executive Office of the U.S. Trustee to adopt uniform guidelines for the U.S. Trustees' review of applications for compensation, and authorize the filing of objections.[198]

Despite its more active role, the U.S. Trustee Program cannot effectively control fees. Ex post facto review of fees by the U.S. Trustee carries with it many of the same problems created by *sua sponte* court review. Further, limited resources and limited information about the relative importance of issues in the case substantially impair the U.S. Trustees' ability to play a significant role in controlling professional costs. The review of fee applications and determination of which items should be compensated is a burdensome and complicated task. Moreover, the U.S. Trustee may have less familiarity with the issues than the court, as the office often declines to expend resources on cases in which creditors and shareholders actively participate.[199] Finally, the need for the United States Trustee's intervention on fee matters in cases where the parties footing the bill do not object is not apparent. Program resources could be better used to facilitate stakeholder objections, monitor trustees and move cases through the process more quickly.

## III. A PROPOSAL FOR REFORM OF THE FEE SYSTEM

The key to developing an effective system for controlling fees in chapter 11 cases lies in a return to the basic financial discipline that controls parties outside of bankruptcy—parties authorized to purchase professional services must pay the associated costs. I propose a change in the administrative expense status of professional fees, combined with a modification of the absolute priority rule, to minimize the externalities that arise under the current system.

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196. 28 U.S.C. § 586 (1994). The U.S. Trustee Program took over the administrative responsibilities formerly handled by bankruptcy judges under the Bankruptcy Act. *See id.*, and H.R. REP. NO. 595, *supra* note 21, at 99–115, *reprinted in* 1978 U.S.C.C.A.N. at 6061–76.

197. *See Bankruptcy Hearings, supra* note 1 (statement of John E. Logan, (then) Director, Executive Office for United States Trustees); *Id.* (statement of Marcy J.K. Tiffany, U.S. Trustee, Region 16, Central Dist. of Calif.); Letter from John E. Logan, (then) Director, Executive Office for United States Trustees, to Sen. Paul Simon, Comm. on Judiciary (Feb. 12, 1992) (on file with the author).

198. Bankruptcy Reform Act of 1994, Pub. L. No. 394, § 224(a), 108 Stat. 4106 (1994). Prior to amendment, 28 U.S.C. § 586(a)(3) directed the U.S. Trustee, "whenever the United States Trustee considers it to be appropriate," to "monitor[] applications for compensation and reimbursement filed under section 330" and to "fil[e] with the court comments with respect to any of such applications." As amended, 28 U.S.C. § 586(a)(3)(A)(i) and (ii) direct the U.S. Trustee, "whenever the United States Trustee considers it to be appropriate," to "review[], in accordance with procedural guidelines adopted by the Executive Office of the United States Trustee,...applications filed for compensation and reimbursement under section 330" and to "fil[e] with the courts comments with respect such application [sic] and, if the United States Trustee considers it to be appropriate, objections to such application." The Executive Office of the U.S. Trustee recently published its second set of Guidelines. *See* U.S. Trustee Guidelines, *supra* note 1.

199. EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES, POLICY STATEMENT REGARDING ADMINISTRATION OF CHAPTER 11 CASES (Mar. 1993).

In addition, a few changes in the Bankruptcy Rules would ensure that DIPs and official committees have sufficient information to make rational choices about potential costs and probable benefits and facilitate participation in fee matters by those required to foot the bill.

### *A. Allocation of Costs to Beneficiaries*

To ensure costs are considered, the DIP and official committees cannot be permitted to spend other people's money. Instead, the priority system must be revamped so that the persons responsible for making the decision to purchase professional services, and who receive the probable benefit from those services, bear the related costs. Allocating costs to the various constituencies which make the decision to seek benefits through litigation should permit creditors and shareholders to better evaluate the costs of chapter 11.

#### *1. Professionals Retained by Official Committees*

I propose paying interim fees to professionals during the case and paying any final fees in full on the effective date of the plan. I would require that fees be paid out of the distribution allocated[200] to the class or classes represented by the committee.[201] Returning to the earlier hypothetical,[202] suppose that the senior unsecureds' committee incurs fees of $50,000, and the subdebt committee $30,000. Before adjustment for fees, those classes would receive distributions of $600,000 and $400,000, respectively. Under my proposal, the professional fees incurred by the senior unsecureds' committee would be deducted from their pre-fee distribution, leaving $550,000 to be divided among the class pro rata. Similarly, the $30,000 for professionals fees incurred by the subdebt committee would be deducted from the $400,000 distribution, leaving $370,000 to be divided among the class pro rata. Senior creditors would not be forced, as they are now, to bear the cost of junior classes' litigation (including unsuccessful litigation) against them.[203] By the same token, because senior classes pay their own professionals, junior classes do not bear the cost of profligate senior classes. If the class represented by a professional is out of the money,[204] compensation to that professional could not be paid from the estate. The effect of this proposal on distributions is illustrated in Table B.

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200. This allocation might be made in accordance with the absolute priority rule, or through agreement by the parties, but would be made *before* any adjustment for professional fees.

201. A committee might represent more than one class of claims or interests. If the classes share equal priority and receive distributions of equal value, allocation of the fees among the affected classes would follow the same system described in the text. For classes with different priorities, the committee's fees might be allocated in proportion to the value of the aggregate distributions to each class. This system is described below with respect to professional costs incurred by the DIP. *See infra* notes 229–34 and accompanying text.

202. *See supra* Table A and accompanying text.

203. Professionals hired by the equity committee could not be paid from the estate, because that class receives no distribution under the plan.

204. I.e., the class receives no distribution from the estate under the absolute priority rule or through an inter-class settlement.

## Table B - Effect of Committee Fees on Distributions Under Proposed System

| Class | Claim Amount | Distribution Before Fees | Fees Spent By Class | Current System — Distribution After Fees | Proposed System — Distribution After Committee Fees[3] |
|---|---|---|---|---|---|
| **Administrative Expenses**[1] | 0[1] | 0 | $200,000 | $200,000 | 0 |
| **Senior Unsecured Claims** | $600,000 | $600,000 | $50,000 | $600,000 | $550,000 |
| **Subdebt Claims** | $400,000 | $400,000 | $30,000 | $200,000 | $370,000 |
| **Common Stock** | Shares | 0 | $50,000 | 0 | 0[4] |
| **DIP Fees**[2] | | | $70,000 | | [See Table C] |
| **Total Distributions to Stakeholders** | | $1,000,000 | | $800,000 | $920,000[5] |

(1) This assumes that professional fees are the only administrative expenses allowed.
(2) DIP fees are presumed to be spent on behalf of the entire estate.
(3) Equal to the amount in column 3 (Distribution Before Fees) minus the amount in column 4 (Fees Spent by Class).
(4) Fees for professionals retained by a committee representing common stock (or any underwater class) would not be paid from the estate under the proposed system.
(5) This amount does not reflect any adjustment for DIP fees, which would further reduce distributions by $70,000. The proposed system, nevertheless, would result in higher distributions to stakeholders than would the current system because payments to professionals for underwater classes would not reduce distributions to more-senior classes.

Several modifications to the Bankruptcy Code would be required to implement this allocation of costs to the purported beneficiaries. First, the priority provisions of the Code[205] would create a separate "priority" category for fees and expenses paid to professionals under section 330.[206] Professional fees would have the same overall priority vis-a-vis other claimants as the constituency represented, but take priority over claims within that class.[207] Second, section 1129(a)(9) of the Code[208] would be modified to provide that professional fees must be paid in cash on the effective date of the plan, only to the extent that a distribution is made[209] to the class represented by such professionals. Finally, the first prong of the absolute priority rule would be altered to provide that the holder of a claim within the dissenting class must receive property with a present value equal to the allowed amount of the claim, less the claimant's share of professional fees.[210]

Apart from these modifications, the court could continue to authorize the payment of professional fees on an interim basis[211] with two caveats: 1) it must appear reasonably certain that the constituency represented will receive a distribution under a plan, and 2) interim fees must be subject to disgorgement in the event interim fees exceed amounts that would otherwise be distributed to that constituency. So long as the professional or committee establishes with reasonable certainty that the class represented will receive property under the plan, continuation of the policy of paying interim compensation to bankruptcy professionals should reduce costs in the long run.[212] In the event circumstances change and the amount of interim fees exceeds the distribution otherwise allocated to the class, the professionals would be required to disgorge the excess fees.[213]

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205. This would include 11 U.S.C. §§ 503 and 507.

206. 11 U.S.C. § 330.

207. The debtor's professionals would receive slightly different treatment as outlined below.

208. 11 U.S.C. § 1129(a)(9) currently requires payment of administrative expenses, including professional fees authorized pursuant to § 330 of the Code, to be paid in full, in cash, on the effective date of the plan of reorganization.

209. Or, would be made, but for the allowance of the professional fees.

210. Currently, 11 U.S.C. § 1129(b)(2)(B) requires that, with respect to a dissenting class of unsecured claims, the plan must (i) provide for distribution of property with a present value equal to the allowed amount of the claims, or (ii) provide that no holder of a claim or interest that is junior to the claims of the dissenting class will receive anything. This proposal would leave the second prong of the absolute priority rule unaffected.

211. 11 U.S.C. § 331 currently authorizes the payment of interim compensation to professionals once every 120 days, or more often if the court permits.

212. Professionals forced to carry the costs of providing services over the entire length of a chapter 11 case, sometimes as much as two or three years, must recoup those costs somewhere. Presumably they increase rates for bankruptcy cases, or alternatively, stop accepting bankruptcy cases. *Cf.* Whitman & Barse, *supra* note 83, at 368 (proposing that committees' professionals be paid only at the end of the case).

213. Fees equal to the distribution that would otherwise be made to the constituency represented do not present a problem, so long as the affected stakeholders receive notice and an opportunity to object to those fees. As in real life, clients may misjudge the probable benefits to be obtained. Moreover, this situation provides professionals with substantial economic incentives to compromise their fees. In the future, committees may be reluctant to hire counsel or other professionals who regularly incur fees equal to the amount of their constituencies' distribution. Alternatively, clients may negotiate to retain counsel under a percentage-of-recovery fee arrangement.

In accordance with the contingent nature of their clients' recovery, professionals retained by classes not clearly in the money could not receive compensation from the estate, whether interim or final, until their clients received some distribution under the plan. Denying compensation in the absence of a recovery should force professionals and clients to carefully measure the probable benefits from litigation against the expected costs. If the contingent nature of the compensation leads to fees based on a percentage of the recovery,[214] adoption of a contingency fee arrangement aligns the interests of the attorneys and their clients.[215] The percentage-of-recovery approach may at times lead to compensation substantially in excess of what would result under a lodestar[216] method, but carries with it the advantages of assuring that the affected stakeholders will always receive some recovery.

Under my system, the contingent nature of the compensation to professionals may lead to reduced representation of junior classes in cases in which recovery to those classes does not appear likely. Reduced representation of classes out of the money (or not clearly in the money) would improve chapter 11. Others have noted the problems created when underwater[217] classes receive distributions from the estate at the expense of senior creditors or shareholders.[218] Classes out of the money may engage in extortionate litigation to force senior stakeholders to give up value. This litigation slows down reorganizations and increases the overall cost of chapter 11.[219] Denying compensation to professionals except where a right to recovery has been demonstrated, effectively takes the underwater classes out of the negotiations.[220] Junior creditors should be discouraged from expending resources on futile exercises where no genuine possibility of recovery exists. Of course, the participation of shareholders or junior creditors may, at times, lead the DIP to adopt a reorganization strategy that increases the overall value of the debtor. My system would not prevent this, but would impose financial discipline on those junior stakeholders.

If a committee representing junior claims or interests were unwilling or unable to hire counsel on a contingency fee basis, an individual stakeholder[221] could hire its own counsel. An equity holder arguing for a higher valuation of the reorganized debtor would be free to participate, but would have to put its money where its mouth is.

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214. This approach requires payment of a risk premium over the regular hourly rates charged when compensation is certain, to compensate professionals for the increase in the risk of nonpayment. *See supra* notes 121–25 and accompanying text. That premium may or may not take the form of a percentage-of-recovery formula.

215. The current system of paying on an hourly basis provides incentives for the professionals to spend as much time as possible on the case, without regard to the effect on the likelihood of success. Under a contingency arrangement, both the client and the attorney have incentives to maximize the recovery and minimize expenses.

216. I.e., hours reasonably spent multiplied by a reasonable hourly rate.

217. Classes not likely to receive any distribution under the absolute priority rule.

218. *See, e.g.*, LoPucki & Whitford, *supra* note 10, at 159; and Weiss, *supra* note 10, at 290–99.

219. *See* Gilson, *supra* note 8, at 318–19.

220. *Cf.* Profs. LoPucki and Whitford's proposal for a "preemptive cramdown" to remove classes out of the money from the case. LoPucki & Whitford, *supra* note 10, at 159. My proposal removes those classes from active participation in the chapter 11 case, without the expense of a valuation early in the case. Instead, the onus of establishing a "right" to participate in the chapter 11 case through professionals paid from the estate is on the party seeking the right.

A change in the standard and treatment for substantial contribution claims would encourage participation by individual stakeholders.[222] Currently, where courts allow claims for substantial contribution, those claims are treated just like professional fees—they have priority as an administrative expense, and are paid by the last class in the money.[223] Present standards for measuring claims for "substantial contribution" do not permit recovery of fees for professional services rendered primarily for the benefit of the client, even where other members of the class benefit.[224] This restriction protects the last class in the money, but reduces the already low incentives for individual stakeholders to participate in chapter 11 cases.

I propose paying substantial contribution claims based only upon actual benefit conferred, and only out of distributions to the class which includes the party in interest who incurred the fees.[225] Like professional fees incurred by official committees, substantial contribution claims would take priority over claims within that class. To contrast the current system and my proposal, assume that before action by a shareholder the plan proposed distributing the residual value of the reorganized company with a total value of $1,000,000.[226] Shareholders would receive nothing. A shareholder spends $50,000 on attorneys' fees, which results in a revised plan paying a fixed sum of $100,000 to shareholders, and the residual value of approximately $900,000 to unsecured creditors. Under the current system, allowance of the shareholder's claim for substantial contribution would reduce distributions to creditors by $50,000, and shareholders would still receive the full $100,000.[227] My proposal would freely permit the shareholder's claim for costs, but charge it against the distribution to that class, leaving shareholders with a net distribution of $50,000.[228] Fiscal

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221. Or, an unofficial committee acting in compliance with Bankruptcy Rule 2019.

222. The Bankruptcy Code permits a party in interest to recover its costs, including professional costs, in making a "substantial contribution" to a chapter 11 case. 11 U.S.C. § 503(b)(3)(D), (b)(4). Currently, judicial definitions of "substantial contribution" impose significant obstacles to recovery under these subsections. Absent an ability to charge the costs, a free rider problem may discourage individual creditors from expending fees to obtain a recovery which benefits the entire class.

223. *See* 11 U.S.C. § 503(b).

224. For services to qualify as a "substantial contribution," they must "directly and materially" contribute to the reorganization, and the benefit to the estate must be more than an incidental one arising from activities the applicant pursued in protecting his or her own interests. *See, e.g.*, Lebron v. Mechem Fin., Inc., 27 F.3d 937, 943–44 (3d Cir. 1994); Manufacturers Trust Co. v. Bartsh (*In re* Flight Transp. Corp. Sec. Litig.), 874 F.2d 576, 581 (8th Cir. 1989); Haskins v. United States (*In re* Lister), 846 F.2d 55, 57 (10th Cir. 1988); Pierson & Gaylen v. Creel & Atwood (*In re* Consolidated Bancshares, Inc.), 785 F.2d 1249, 1252–54 (5th Cir. 1986). Creditors are presumed to be acting in their own interests unless their efforts transcend self-protection. *Haskins*, 846 F.2d at 57. It is hard to imagine an individual stakeholder willing to incur liability for fees that were *not* primarily for its own benefit.

225. Claims for costs incurred by creditors that file an involuntary petition, recover for the benefit of the estate property transferred or concealed by the debtor, or prosecute a criminal offense relating to the case or to the business or property of the debtor, could continue to be allowed as regular administrative expenses. *See* 11 U.S.C. § 503(b)(3)(A), (B), (C). These services appear to benefit all parties in the case, and requiring them to be paid by the last class in the money (or out of the proceeds of any recovery) is not unfair.

226. This $1 million figure would be affected by the allowance of administrative expense claims, including claims for substantial contribution.

227. This illustrates the source of judicial reluctance over shifting costs from individual stakeholders to the "estate."

228. In other contexts, including class actions, courts routinely permit professionals to recover fees when they create a fund in court.

restraints against over-litigation remain because the client pays the fees if the court does not allow a substantial contribution claim.

*2. Professionals Retained by the DIP*

Allocating the DIP's fees is more difficult because of the complexity in identifying which "stakeholders" the DIP represents, or which stakeholders might have benefitted from the services. The DIP owes fiduciary duties to creditors and shareholders, whose interests frequently conflict. Further, agency problems may cause management to act to preserve their jobs and compensation at the expense of creditors and shareholders. Adoption of a variation on the allocation system proposed for professional fees incurred by official committees could diminish these problems.

I propose allocating professional costs incurred by the DIP among all classes of unsecured claims and equity interests in proportion to the value of the property distributed to each class under the plan of reorganization. The precise allocation of the DIP's professional costs could be left to agreement of the parties if the plan is consensual, and based strictly on distribution values if cramdown of the plan is required.[229]

Assume a plan under which senior unsecured creditors receive distributions totalling $600,000, subdebt $400,000, and that the DIP incurred professional fees totalling $70,000. Distributions to these classes total one million dollars in the aggregate. Senior unsecured creditors, as a class, would pay $42,000 or 6/10ths of the DIP's total fees,[230] and the subdebt would pay the remaining $28,000 or 4/10ths of the fees. Table C demonstrates the effect of my proposal on distributions and contrasts my proposal with the current system.

Allocation of the DIP's professional costs among all stakeholders receiving distributions would increase accountability, and spread the professional costs among the groups in rough proportion to the extent to which the DIP represented their respective interests.[231] Management that holds claims or interests in these classes may become more cost-conscious, as they too bear the burden of professional fees.[232] Of course, allocation of costs among the classes is an accounting mechanism and does not directly decrease the DIP's professional costs. Increased accountability may, however, lead to increased pressure on the debtor and management to closely control fees[233] and break the "conspiracy of silence" on fee questions.[234]

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229. Methods which allocate the costs among these same groups using measures other than value distributed under a plan could achieve the same cost-control goals. I suggest adopting distribution values as a convenient measuring stick because courts must value distributions anyway if a class of claims or interests rejects the plan. *See* 11 U.S.C. § 1129(b).

230. Fees incurred by professionals retained by the official committee representing unsecured creditors would further reduce the recovery, as discussed above.

231. Requiring senior classes to pay some proportion of the chapter 11 costs is not unfair. Outside of bankruptcy, creditors would have to incur some collection costs.

232. I considered separately imposing a portion of the DIP's costs on management, but concluded such a system would encourage strategic behavior. Management could, and likely would, use their control over the debtor's business to recoup any losses on "claims" through increases in salary or other benefits.

233. *See infra* note 246 and accompanying text.

234. *See supra* notes 140–43 and accompanying text.

## Table C - Effect of All Fees on Distributions Under Proposed System

| Class | Claim Amount | Distribution Before Fees | Fees Spent By Class | Current System — Distribution After Fees | Proposed System — Distribution After Committee Fees[4] | Proposed System — DIP Fees | Proposed System — Distribution After All Fees |
|---|---|---|---|---|---|---|---|
| Administrative Expenses[1] | 0[1] | 0 | $200,000 | $200,000 | 0 | | |
| Senior Unsecured Claims | $600,000 | $600,000 | $50,000 | $600,000 | $550,000 | $42,000 | $508,000 |
| Subdebt Claims | $400,000 | $400,000 | $30,000 | $200,000 | $370,000 | $28,000 | $342,000 |
| Common Stock | Shares | 0 | $50,000[3] | 0 | 0 | | 0[3] |
| DIP Fees[2] | | | $70,000 | | | $70,000 | |
| Total Distributions to Stakeholders | | $1,000,000 | | $800,000 | $920,000 | | $850,000 |
| Total Spent on Professional Fees | | | | $200,000 | | | $150,000 |

(1) This assumes that professional fees are the only administrative expenses allowed.
(2) DIP fees are presumed to be spent on behalf of the entire estate.
(3) Fees for professionals retained by a committee representing common stock (or any underwater class) would not be paid from the estate under the proposed system.
(4) Equal to the amount in column 3 (Distribution Before Fees) minus the amount in column 4 (Fees Spent by Class).

*3. Ripple Effects of Cost Reallocation*

My cost allocation system gives rise to two potential concerns: 1) "good" litigation (litigation that increases the size of the estate) may be discouraged; and 2) the cost of borrowing from senior creditors may increase as those creditors attempt to recoup costs shifted from the last class in the money. Although reallocation of costs will brake the amount of litigation and may impose an increased burden on senior creditors in some instances, overall, stakeholders will benefit.

a. Reduction in "Good" Litigation

In general, the parties in a chapter 11 case should agree on the reasonableness of expenditures for professional fees that result in a net increase in the size of the estate. When considered separately, however, the various classes of claims and interests may reach different conclusions on the usefulness of any particular piece of litigation. For example, senior creditors expecting payment in full may receive little benefit from an increase in the estate.[235] Moreover, costs of litigation may be such that any single committee making a cost-benefit analysis would decline to undertake the litigation, even where collectively the litigation would result in a net benefit to the estate (or two or more classes of stakeholders).[236]

Requiring classes to bear the costs of their committee's professionals and allocating the costs of the DIP's professionals among all classes should not unduly discourage the concerned parties from bringing litigation with a net positive value. If the DIP fails to bring suit, through pressure from non-benefitting stakeholders or otherwise, then the committee or committees representing any benefitting classes can bring suit in the DIP's stead.[237] If more than one class of stakeholders would benefit from the litigation,[238] then the benefitting classes could agree to share the costs of the suit.[239] In circumstances

235. In such a case, the senior creditors might pressure the DIP not to bring suit because, without more, the senior creditors would incur costs without receiving any corresponding benefit.

236. To illustrate this principle, assume that the estimated recovery from a lawsuit is $100,000 and $50,000 of professional fees would be required to obtain that recovery. Collectively, the benefitting classes would incur the fees, because the estate receives a net increase of $50,000. If two separate classes shared that benefit equally neither would, on its own, file suit. The expected benefit to either class ($50,000) would equal the costs necessary to obtain that benefit ($50,000), so no suit would be filed unless the parties agreed to share costs. My proposal provides a mechanism for the parties to reach agreement.

237. *See, e.g., In re* STN Enterprises, 779 F.2d 901, 904 (2d Cir. 1985); *In re* Allegheny Int'l, Inc., 93 B.R. 903, 905–07 (Bankr. W.D. Pa. 1988); *In re* Gander Mountain, Inc., 29 B.R. 260, 262 (Bankr. E.D. Wis. 1983). Although courts generally do not permit committees to bring suit unless the DIP has unjustifiably refused to pursue the action (*see In re* STN Enterprises, 779 F.2d at 905), more accurate allocation of the costs and benefits among the classes would be a further reason to permit committees to bring suits on behalf of the estate, particularly where the debtor consents.

238. More than one class might benefit where the expected recovery from a suit is large enough to "top off" the last class in the money and provide for some distribution to more junior stakeholders as well.

239. Except as the parties otherwise agree to share the costs of litigation, professional fees (other than DIP fees) for litigation should be borne solely by the constituency represented by the committee filing suit. Courts should view claims that creditors brought suit for the benefit of

where the parties cannot agree on an allocation of costs, the DIP or a committee might pay a premium to retain counsel on a contingency fee basis to assure that senior creditors will not be required to bear the cost of the suit. Alternatively, where suit is brought by a single committee, that committee might be permitted to recoup its full litigation costs from the recovery before sharing that recovery with any other class.[240] My proposal would require parties to carefully evaluate the best method of compensation, but would not prevent suits with positive value from being filed.

b. Increased Borrowing Costs

At first blush, my proposal would appear to lead to increased borrowing costs, as creditors required to bear costs not mandated by the current system (i.e., fees for their professionals and a portion of the DIP's fees) seek to recoup those costs through higher fees or interest rates on loans. Even assuming that professional costs in bankruptcy have a measurable effect on borrowing costs,[241] consideration of the current system in its full complexity suggests that senior creditors may be better off under my system.

The current system leaves the last class in the money holding the bag for all professional costs. Any savings obtained by protecting senior creditors from the need to pay professional fees go, not to the debtor, but to more junior creditors who now bear the increased risk of loss from fees in bankruptcy. Further, senior creditors cannot escape the risk that they will be the last class in the money and therefore required to pay fees for classes both in, and out of, the money. This suggests that, placed behind a Rawlsian "veil of ignorance"[242] and asked to devise a system that would be in their long-term interest, stakeholders would prefer my system because it: 1) reduces the overall quantum of fees paid from the estate; 2) excuses the last class in the money, whether a senior or junior class, from bearing costs incurred by classes out of the money; and 3) significantly increases each class's control over the costs it can be forced to bear.

### *B. Information on Costs*

Settlement theory posits that decisionmakers can and will make rational choices weighing the costs and benefits of litigation. That theory presupposes information about costs is available. As noted above, the current system

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shareholders (or vice versa) with great skepticism; the parties' interests are frequently adverse. Further, litigation over whether a class did or did not benefit from litigation entails additional transaction costs. Finally, a rule requiring agreement on cost sharing would encourage all parties to evaluate the costs and benefits of litigation before suit is filed.

240. Admittedly, this alternative would not work for non-cash recoveries (e.g., the avoidance of a security interest).

241. It is not apparent that the professional costs of bankruptcy, even when large in an absolute sense, would have a measurable effect on the cost of borrowing. Before a loan is made, the lender presumably considers the return on investment, the risk of loss, and the size of any possible loss, in setting the price for the loan. Professional fees in bankruptcy are only one part of the possible loss. Similarly, the risk of the borrower landing in bankruptcy is only one part of the risk of loss, and the lender likely views that risk as remote. Logic therefore suggests that a reallocation of costs will not necessarily affect the cost of borrowing.

242. *See* JOHN RAWLS, A THEORY OF JUSTICE (1971). Rawls contended that if asked to choose principles of justice from behind a "veil of ignorance" that restricted what they could know of their own position in society, people would choose rules to safeguard themselves against the worst possible outcome rather than rules to maximize overall utility.

provides none. The lack of information further leads to a lack of price competition because the entities authorized to purchase professional services cannot compare alternatives. Consequently, increasing information about the costs of professional services is a second essential step in efforts to effectively control fees in chapter 11 cases.

*a. Disclosure of the Effect of Fees on Distributions*

A compensation system that allocates costs to each class of creditors should itself improve information on costs and increase price competition. Chapter 11 disclosure standards require that plan proponents provide all creditors and equity holders with a disclosure statement containing "adequate information" to permit them to make an informed judgment about the plan.[243] Currently, disclosure statements generally list an estimated figure for administrative expenses, without indicating which party incurred the fees, how those fees affect distributions, or even which classes paid those fees.[244] Under my plan, where an award of professional fees reduces the stakeholders' distribution, "adequate information" would require disclosure of the amount of the deduction in relation to the size of the claim and identification of the party incurring the fees.[245]

My proposal would work to create a price-sensitive competitive market for professional services in chapter 11. Creditors and shareholders would receive information on precisely how much the DIP's and committee's professionals cost them. Over time, the accumulation of this information could provide consumers of professional services in chapter 11 with a means for comparison shopping.[246] Clients are unlikely to hire professionals whose fees regularly consume a large proportion of the estate, and stakeholders may bring pressure to bear on a debtor who selects counsel with a track record of high fees. Alternatively, in cases where the requested fees would absorb a substantial portion of the distributions, debtors or committees recommending acceptance of a plan might force professionals to reduce fees, much as a private client insists on a reduction where the costs of litigation appear excessive in light of the amount at stake.

*b. Pre-service Disclosure of Fees*

Requiring professionals to provide cost estimates or budgets at the time of retention, and periodically thereafter, could further improve decisions about whether to purchase professional services. Oddly enough, in large chapter 11 cases professional services are the only aspect of the debtor's business where budgets and business plans are not required. Submission of a detailed, written statement of the issues likely to arise, the work planned on each issue, and the expected cost, would greatly enhance a committee's or a DIP's ability to evaluate whether the expected benefit from the services justifies the cost.

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243. 11 U.S.C. § 1125(a)(1).

244. A class out of the money at plan time may have been in the money before payment of professional costs. Disclosure statements would not explicitly note that under current practice.

245. This requirement could be implemented through interpretation of the current language of 11 U.S.C. § 1125(a)(1), an explicit amendment to that subsection, or a modification of the Bankruptcy Rules.

246. For example, a committee interviewing prospective counsel might request information on the fee/distribution ratio for counsel's last 10 or 15 cases.

Budgeting permits the decisionmakers to consider costs before purchasing services and, over time, would permit the same type of comparison shopping discussed above.[247] Modifications could occur as new and unexpected issues arise in the case. Some judges have already adopted budgeting procedures in chapter 11 cases.[248] The best of these procedures could be formalized and incorporated into the Bankruptcy Rules.

*c. Notice of the Opportunity to Object to Fees*

Apart from measures that increase the quality of information about fees, simple changes in notice procedures would increase the amount of information available, and accordingly increase stakeholder participation in fee review proceedings. Courts frequently lament the lack of creditor participation in fee matters without considering how the limited notice procedures adopted by many courts add to that problem.[249] Bankruptcy Rule 2002 should be amended to require notice[250] of fee applications to all stakeholders affected and disclosure of the award's expected impact on distributions.[251] A new "official form" notice could explain where to obtain copies of the application and describe, in plain language, how to object to fees.[252] Finally, courts could eliminate the requirement that a party in interest retain an attorney to submit objections[253] and permit consideration of written objections submitted by any party. These procedures would assure that the parties affected receive notice and an opportunity to be heard.

### *C. Limit Court Participation to the Adjudication of Disputes*

Elimination of *sua sponte* reductions in fees by the bankruptcy courts is the third and final step in building an effective system for controlling professional costs in chapter 11 cases. Realignment of the costs and benefits in

247. Committees or DIPs interviewing prospective attorneys or accountants might ask not only for budgets, but also for information on how often the professionals exceeded predicted budgets in the past.

248. *See The Costs of Bankruptcy: A Roundtable Discussion*, 1 AM. BANKR. INST. L. REV. 237, 272 (1993) (Harry Jones, former U.S. Trustee for the Second Circuit, discussing budgeting procedures followed in the *Drexel–Burnham* chapter 11 case) [hereinafter *Roundtable Discussion*]; Leif M. Clark, *Getting a Handle on Fees—One Approach*, 13 AM. BANKR. INST. J. 11 (1994).

249. In large chapter 11 cases courts often restrict notice of proceedings to the DIP, the U.S. Trustee, official committees, and stakeholders who specifically request that copies of all notices be mailed to them. *See* FED. R. BANKR. P. 2002(i). The primary recipients of notices under this rule, DIPs and official committees, are represented by professionals paid from the estate for whom the "massive backscratching" urge is the strongest.

250. Notice might be given with each application for interim fees, or only upon the final application, depending on the number of creditors and the cost of sending notices.

251. Even without knowing the value of distributions under the plan, the applicant could predict the approximate pro rata cost of the fees, particularly for professionals representing only one constituency.

252. The U.S. Trustee Program might play an active role in developing these instructions and providing information to stakeholders on how to file an objection.

253. Frequently the parties in interest in large chapter 11 cases will be corporations. If an objection to professional fees made by an agent of the corporation raises questions about the agent's improper appearance in court on behalf of another person (i.e., the unauthorized practice of law, assuming the agent is not a lawyer), then the notice could direct the submission of written objections to the U.S. Trustee. In turn, the U.S. Trustee could act as the "attorney" for those submitting objections. This process could also be followed in cases where no committees are appointed.

chapter 11 would require decisionmakers to spend their own money, at least in part, when purchasing professional services. Other parties affected by the expenditure would receive notice of the likely impact on distributions, and have an opportunity to object. In those circumstances, if parties paying the bill do not object, why should anyone else care?

The "duty" of bankruptcy courts to review fee requests, even in the absence of objections, absorbs substantial judicial resources in protecting those who do not bother to protect themselves and does not necessarily lead to better results. Review of voluminous applications with hundreds or thousands of pages of detailed time records presents an onerous task and consumes a significant portion of judicial time.[254] Courts could better spend this time on moving chapter 11 cases through their dockets more quickly. Frequently, the parties affected are not babes in the woods, but large companies with extensive credit departments or financially sophisticated investors. The court's ability to make "better" judgments about costs and benefits than these parties is not apparent. Given these difficulties, and the increased costs to the system resulting from judicial regulation,[255] judicial regulation of costs (in the absence of an objection by a party in interest) should be eliminated under a revamped system.

### *D. U.S. Trustee Participation Under the Revised System*

The U.S. Trustee might play a very effective role in controlling fees under a revamped system, albeit a very different role from that contemplated by the 1994 Amendments. Ex post facto attempts at regulation by the U.S. Trustee carry with them many of the same problems as *sua sponte* court review. In cases where an official committee has been appointed and stakeholders are actively represented, the U.S. Trustee's participation in fee matters adds little benefit and consumes scarce resources.[256] Nevertheless, cases in which a trustee is appointed or cases in which there is no official committee present very different problems. There, intervention by the U.S. Trustee could be useful.

In chapter 11 or chapter 7 cases where a trustee is appointed, the U.S. Trustee system could control professional fees by black-balling big spenders from the slate of trustees. The United States Attorney General prescribes by rule the qualifications for trustees.[257] Those qualifications could include a requirement that total professional costs in prior cases be below a target level[258] for the trustee to remain eligible for appointment in additional cases. Where the U.S. Trustee appoints a trustee, who then selects counsel or other professionals paid from the estate, appointments carry vestiges of a patronage system.[259] The integrity of the trustee system is implicated where the United States Trustee (as a government official) appoints persons to manage the estate. This approach would provide strong incentives for trustees to control fees without the need

254. *See, e.g., Roundtable Discussion, supra* note 248, at 258. *See also In re* Continental Airlines, Inc., 138 B.R. 439 (Bankr. D. Del. 1992).

255. *See supra* notes 162–71 and accompanying text.

256. The U.S. Trustee might, however, play a useful role in these cases by facilitating stakeholder objections. *See supra* notes 250–51 and accompanying text.

257. 28 U.S.C. § 586(d).

258. This level could be set after a study of prior cases and an evaluation of the appropriate level of expenditures for professional fees.

259. *Cf. supra* notes 175–76 and accompanying text.

for the United States Trustee to incur the expense of reviewing and filing objections to individual fee applications.

In cases where no official committee is appointed, the U.S. Trustee might facilitate stakeholder objections by serving as "counsel" to individual stakeholders who want to object to fees. The notice of the request for compensation might advise stakeholders that they can object to fees, or that the U.S. Trustee can assist them in filing objections. This use of Program resources might be more productive than the current review process.

## IV. CONCLUSION

The recent furor over professional costs in bankruptcy cases makes reform of the fee system inevitable. Reform, however, should not rely on the tired shibboleth of increasing court control over professional fees. Instead, reform must address the basic root of the problem; chapter 11 currently permits committees and DIPs purchasing professional services to spend other people's money. The solution lies in realigning costs and benefits, adjusting the rules to provide more information about costs, and leaving the primary decisions about the reasonableness of professional costs to the parties with an economic stake in the outcome.