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Challenges Ahead for Chapter 11 Retained Professionals: The Implications of *Baker Botts v. Asarco*

The U.S. Supreme Court's 6-3 split decision in Baker Botts LLP v. Asarco LLC[1] will have long standing implications for all bankruptcy professionals' compensation, potentially making it much more costly for all professionals retained in chapter 11 cases. In this case, the Court ruled that amounts incurred by a law firm litigating a fee dispute did not constitute "services rendered" to a debtor, and as such, were not required to be paid by the debtor's estate. The ruling strictly interprets the language of §330(a) of the Bankruptcy Code, which applies to all professionals retained in chapter 11 cases, ranging from investment banks, financial and valuation advisors to law firms. The Supreme Court's holding serves to tilt the playing field against these professionals, likely increasing fee disputes, as debtors and creditors will no longer fear that a debtor's estate will be responsible for amounts incurred by professionals in responding to fee objections. Given the serious implications of the ruling, all bankruptcy professionals should be aware of this decision and its potential repercussions.

Background of the Case

Baker Botts were retained in 2005 pursuant to § 327(a) of the Bankruptcy Code to serve as counsel to Asarco in its chapter 11 case. Asarco, a mining and smelting company, was owned at the time by Mexican mining corporation Grupo Mexico. In the course of its representation, Baker Botts commenced an adversary proceeding against Grupo Mexico, asserting a fraudulent transfer claim based upon the transfer of certain assets from a Grupo Mexico subsidiary, Southern Copper Corp., of which Asarco owned shares, to another Grupo-owned property. The action resulted in a $7 billion verdict against Grupo Mexico, representing the largest fraudulent transfer judgment in chapter 11 history. As a result of the award, all of Asarco's creditors were paid in full. Notwithstanding the chapter 11 case, Grupo Mexico retained control of and eventually reacquired Asarco.

At the close of Asarco's chapter 11 case in 2011, Baker Botts sought final approval pursuant to § 330(a) of approximately $117 million in fees, $113 million of which were based upon hourly compensation plus $4 million in fee enhancements. Asarco objected and the Bankruptcy Court held a trial over the disputed fee request. Baker Botts spent an additional approximately $5.2 million defending its fee request, and further sought to be awarded these fees arising from the fee defense from the debtor's estate as well. The Bankruptcy Court awarded Baker Botts all of its fees, and Asarco appealed the bankruptcy judge's decision to U.S. District Court for the Southern District of Texas, which subsequently held in 2012 that Baker Botts was entitled to its fees, including the $5.2 million incurred while defending its fee request.

Asarco again appealed the matter, this time to the U.S. Court of Appeals for the Fifth Circuit. In April 2014, the appeals court reversed, holding that Baker Botts should not be paid the $5.2 million because the law governing attorney compensation does not provide for compensation for defending fee applications. Baker Botts appealed the Fifth Circuit's decision to the U.S. Supreme Court, arguing that the Fifth Circuit's decision was contrary to a Ninth Circuit appellate decision that found that attorneys are entitled to such fees.

The Decision

The majority's decision, written by Justice Thomas, first determined that under the American common law system, "each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise." While Justice Thomas recognized that Congress has in certain instances altered the "American Rule," he held that courts should not diverge from this governing principle "absent explicit statutory authority."[2]

Justice Thomas next applied a close textualist reading to § 330(a)(1)(A) of the Bankruptcy Code to determine whether Congress specifically and explicitly altered the American Rule with regard to this statute. Section 330(a) itself authorizes debtors to pay their retained professionals, including banks, advisors and counsel, "reasonable compensation for actual, necessary services rendered." 11 U.S.C. § 330(a)(1)(A). Justice Thomas determined that the term "services rendered" refers to services "performed for another" and found that time spent litigating a fee application against the bankruptcy estate cannot be described as "labor performed for" the

bankruptcy estate.[3] As a result, Justice Thomas held that Congress did not expressly depart from the American Rule in § 330(a) to permit compensation for fee defense litigation by professionals retained to assist in bankruptcy proceedings. Conversely, in his dissent, Justice Breyer, found that § 330 did, in fact, provide for such payment, writing that "[t]he statute permits compensation for fee defense work as a part of compensation for the underlying services."[4]

The U.S. Government filed an amicus brief arguing that, among other things, the Court should provide a "judicial exception" to the governing American Rule in order to compensate fee defense litigation and ensure that talented professionals continue to undertake bankruptcy work. Responding to this argument, Justice Thomas wrote that no attorneys are entitled to such fees absent express statutory authority and that even if the result harmed the bankruptcy bar, the Court has no "roving authority … to allow counsel fees .. whenever [it] might deem them warranted."[5]

Importantly, Justice Thomas also distinguished fees related to litigating a fee dispute from fees associated with preparing a fee statement, which are explicitly allowed to be paid pursuant to § 330(a)(6). The Court held that, unlike time spent litigating a fee dispute, which serves to benefit only the professionals whose fees are in dispute, time spent preparing a fee statement qualified as a "service" to debtors and other parties because such work allowed such parties to understand the various fees being charged, allowing them to possibly even dispute the bill.

Potential Implications

The *Asarco* decision will likely have profound negative effects on professionals representing debtors and creditors' committees in chapter 11 cases in the future. Unlike professionals representing individual creditors, or even creditors paid by debtors pursuant to indemnification provisions or DIP agreements, investment banks, advisors and lawyers retained by a debtor's estate – even those professionals working on a contingent fee basis – ultimately must submit fee applications pursuant to § 330 of the Bankruptcy Code, and all such fees must be approved by the bankruptcy court. Debtors and creditors receive notice of such fees and may object to the award of such fees. By holding that professionals, and not a debtor's estate, will now be responsible for any fees and expenses arising in a fee disputes, the ruling changes the incentive structure and tilts the current playing field, as debtors and creditors will have no disincentive not to challenge the fees of professionals. Rather, increases in distributions for junior and unsecured creditors may directly result from reductions in fees paid to professionals. The Court's assurances that Bankruptcy Rule 9011, the Bankruptcy Code's analogue to Civil Rule 11, which allows courts to impose sanctions for frivolous suits, offers little by way of assurances that such suits will not be brought.[6] As a result, given that there is little disincentive to bring such suits, and a possibly large gain, the result will likely be not only a rise in fee disputes over legitimate concerns as fee disputes become less expensive for debtors and creditors, but also a rise in fee disputes brought purely for economic reasons. Further, given the enormous costs that may result in long and drawn-out fee disputes, various parties may also use fee disputes to gain leverage over a debtor and their professionals, raising numerous conflict concerns.

Further, because professionals will have to pay the costs associated with their own fee defense litigation, the result will be that representing debtors and creditors' committees will be much more expensive, driving certain professionals from the marketplace. Parties may seek, as a means to avoid such a result, to provide for contractual language in their retention papers that any fees associated with a fee dispute will be paid by the debtor's estate, but it is uncertain whether the inclusion of specific language on this point will override the holding in *Asarco*. Investment banks, financial and valuation advisors and lawyers may, instead, simply seek to turn to work whereby they can be assured a full return of their efforts, rather than be subject to lengthy and costly fee disputes, exactly the fear that the government raised in its amicus brief. Given that the *Asarco* ruling was from the U.S. Supreme Court, however, absent an amendment to the Bankruptcy Code by Congress, the decision will stand.

1 *Slip Opinion*, Decided June 15, 2015.

2 *Slip Opinion, Majority Opinion* at 4.

3 *Id*. at 6.

4 *Dissent* at 1.

5 *Majority Opinion* at 13, *citing Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 260 (1975).

6 *Id*. at footnote 4.

For More Information

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