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# *ASARCO* and the High Cost of Getting Paid in the Fifth Circuit (and Maybe Everywhere)

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This term, the U.S. Supreme Court will decide whether § 330(a) of the Bankruptcy Code grants a bankruptcy judge the discretion to award compensation for the defense of a fee application. This issue — one dear to any bankruptcy professional forced to defend a fee application — comes before the Court from the recent decision of the U.S. Court of Appeals for the Fifth Circuit in *In re ASARCO LLC*.[1] The court held that compensation for a successful defense of a fee application is never authorized by § 330(a).

At stake for the petitioning law firms is whether they will be permitted to recover approximately $5.3 million of fees and expenses incurred in successfully defending their entitlement to recover approximately $120 million of "core fees" for their service as debtors' counsel during the 52-month-long ASARCO bankruptcy. The anticipated ruling from the Supreme Court will resolve a circuit split, with the Fifth and Eleventh Circuits and a handful of lower courts aligned on one side of the issue, and the Ninth Circuit and a host of lower courts aligned on the other side.[2]

## ASARCO's Chapter 11 Case

ASARCO, an integrated copper mining, smelting and refining company, entered chapter 11 on Aug. 9, 2005, laden with billions of dollars' worth of environmental, asbestos and toxic tort liabilities, and beset by labor strife and other operational challenges. Early in ASARCO's bankruptcy case, creditor recoveries were expected to be just cents on the dollar.

Central to later events, soon thereafter ASARCO's CEO and its entire board resigned. Although ASARCO's ultimate parent, Grupo México, appointed a replacement director, he was viewed by virtually every other constituency as unduly conflicted. By January 2006, the bankruptcy court had approved a stipulation for the appointment of two independent directors and further safeguards to the board's independence, and a special committee had been established to oversee matters with Grupo México and its affiliates.

In February 2007, ASARCO filed suit against two of its parent entities, ASARCO Inc. (the parent) and Americas Mining Corp. (AMC), both of which were also Grupo México subsidiaries. ASARCO sought damages for fiduciary duty breaches and to avoid a fraudulent transfer arising from a 2003 sale to AMC of ASARCO's valuable controlling interest in Southern Copper Corp. (SCC). Two years later, the district court entered final judgment for ASARCO's estate valued at between $7 billion to $10 billion. As the Fifth Circuit later noted, the SCC judgment "was the largest fraudulent transfer judgment in Chapter 11 history."[3]

The SCC judgment became the basis for a chapter 11 plan funded by ASARCO's parent that paid all of ASARCO's creditors in full, with interest, in exchange for the parent regaining control of reorganized ASARCO LLC (hereinafter, "RA"), which emerged from bankruptcy with minimal debt, $1.4 billion in cash, and liberated from its massive environmental, asbestos and toxic tort liabilities. The bankruptcy court later described ASARCO's reorganization as "probably the most successful Chapter 11 of any magnitude in the history of the Code."[4] However, after the plan became effective, the real fireworks began.

## Proceedings on the Fee Applications

On Feb. 8, 2010, ASARCO's lead bankruptcy and litigation counsel, Baker Botts LLP, filed its fee application requesting final approval of $135,870,714.58 in fees and $6,046,135.06 in expenses.[5] Included in the requested fees was a 20 percent premium (about $22.6 million) over the hourly rates that Baker Botts had charged during the bankruptcy. In addition, Baker Botts sought to recover approximately $8.5 million of fees and expenses that it had incurred in defending its fee application, including approximately $5.2 million allocated to the defense of its core fees and expenses.

Prior to filing of Baker Botts' final fee application, no party had objected to the firm's interim fee applications throughout the 52-month-long bank-

1 751 F.3d 291 (5th Cir. 2014).

2 *Compare ASARCO*, 751 F.3d at 299-302 (*per se* not allowed); *Grant v. George Schumann Tire & Batt. Co.*, 908 F.2d 874, 882-83 (11th Cir. 1990) (same); *In re Wireless Telecom. Inc.*, 449 B.R. 228, 236-38 (Bankr. M.D. Pa. 2011) (same); *with, e.g., In re Smith*, 317 F.3d 918, 927-29 (9th Cir. 2002) (allowing fees for successful defense); *In re Worldwide Direct Inc.*, 334 B.R. 108, 111-12 (D. Del. 2005) (same).

3 *ASARCO*, 751 F.3d at 293.

4 *In re ASARCO LLC*, No. 05-21207, 2011 WL 2974957, at *22 (Bankr. S.D. Tex. July 20, 2011) (internal quotations omitted).

5 Baker Botts' co-counsel filed a fee application for its core fees and a 20 percent fee enhancement.

ruptcy case. Even Baker Botts' $142 million final application drew no objections from any party other than RA.

### Bankruptcy Court Proceedings

RA, by then Baker Botts' former client and now again under the control of the parent, vigorously contested Baker Botts' core fees (objecting to more than $20 million of its fees) and the 20 percent premium. This challenge included "a discovery request covering every document [that] Baker Botts produced during the 52-month bankruptcy, resulting in the production of 2,350 boxes of hard copy documents and 189 GB of electronic data."[6]

Following a six-day trial, the bankruptcy court held that RA's objections to Baker Botts' core fees and expenses were meritless. As to Baker Botts' requested fee enhancement, although highly flattering of the work of the Baker Botts attorneys, the bankruptcy court limited the 20 percent fee enhancement to services rendered in the SCC litigation.[7] Fee enhancements, the bankruptcy court observed, "should reward rare and exceptional work and should be tied to both the effort and the outcome."[8]

As to fees and expenses incurred in defending the fee applications, after extensively reviewing various authorities, the bankruptcy court concluded that it had the power to award such fees under § 330(a) and that it should apply the lodestar analysis with the § 330(a) factors to determine their reasonableness. Yet for all its careful attention to the applicable law, the bankruptcy court found, with minimal explanation, that only $5 million of the $8 million of the defense fees was reasonable.

### District Court Appeals

In RA's appeals to the district court, it abandoned its objections to Baker Botts' core fees but continued to dispute the fee enhancements and fees for defending the fee applications. The district court affirmed in most respects, except for the bankruptcy court's failure to provide findings supporting the $5 million award of defense fees to Baker Botts.[9]

### Fifth Circuit Appeal

In RA's subsequent appeal to the Fifth Circuit, it continued to challenge the bankruptcy court's rulings awarding premiums to the law firms and authorizing the law firms under § 330(a) to recover fees for the defense of their fee applications. RA did not pursue further review of the bankruptcy court's discretionary determination as to the amount of defense fees that were recoverable.

Although RA lobbed a variety of attacks at the bankruptcy court's decision to award premiums to the law firms, all fell flat before the Fifth Circuit, which affirmed the fee enhancements in their entirety. However, RA found a receptive audience in the Fifth Circuit for its contention that § 330(a) does not authorize compensation for the fees and expenses professionals incur in defending their fee applications. Initially, the Fifth Circuit acknowledged that § 330(a)(3)(C) requires consideration of "whether the services were necessary to the administration of, *or* beneficial … *toward the completion of, a case*."[10] The panel's opinion also recognized that § 330(a)(4)(A)(ii) uses the same disjunctive phrasing in describing the services for which no compensation can be allowed.[11]

**The *ASARCO* court proffered two suggestions to professionals: They can anticipate the possibility of not being reimbursed for defending fee applications by (1) adjusting upward their hourly rates and (2) more thoroughly documenting their fee applications.**

Nevertheless, the Fifth Circuit next focused almost exclusively on whether the services that a professional provides in defending its fee application are services that are likely to benefit a debtor's estate. Answering this question in the negative, the panel observed that "[t]he primary beneficiary of a professional fee application, of course, is the professional."[12] It aligned itself with the Eleventh Circuit's *Grant* opinion.[13] However, its reliance on *Grant* is questionable, as the opinion pre-dates the 1994 amendments to § 330(a), which expanded the compensation standard from focus on "benefit to the estate" to include services that "were necessary to the administration of … a case under [the Bankruptcy Code]" or that were "beneficial … toward the completion of … a case."[14]

The court found further support in § 330(a)(6), which provides that "[a]ny compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application."[15] According to the Fifth Circuit, "the specification of an award for 'preparation of a fee application'" implies that Congress was excluding fees for defending a fee application by the omission of such language.[16] Moreover, the panel reasoned, § 330(a)(6)'s reference to the "level and skill reasonably required to prepare the application" somehow "emphasizes scrivener's skills over other professional work."[17] The inclusion of this provision, according to the court, was only necessary if Congress believed that preparation of a fee application could not otherwise satisfy the "reasonable and necessary" requirement of § 330(a)(1)(A).[18]

Relying primarily on the Ninth Circuit's *In re Smith* opinion,[19] the law firms also argued that professional fees incurred in defending fee applications were "necessary" to the case's

6 *ASARCO*, 751 F.3d at 293.
7 Co-counsel received a 10 percent fee enhancement for its services.
8 *ASARCO*, 2011 WL 2974957 at *24.
9 On remand, the bankruptcy court allocated all $5 million to the defense of Baker Botts' core fees and reduced certain of its defense-related expenses.
10 *ASARCO*, 751. F.3d at 299 (quoting 11 U.S.C. § 330(a)(3)(C)) (emphasis supplied)).
11 *Id.* at 299 (citing 11 U.S.C. § 330(a)(4)(A)(ii)).
12 *Id.* at 299.
13 908 F.2d at 882-83.
14 *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994).
15 11 U.S.C. § 330(a)(6).
16 *ASARCO*, 751 F.3d at 300.
17 *Id.*
18 *Id.*

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administration. This notion, the Fifth Circuit responded in expressly rejecting *Smith*'s approach in favor of that in the Eleventh Circuit's *Grant* decision, unduly expands the concept of what is "necessary" in this context.[20]

What then follows in the opinion is less of a further dissection of the statute and more of an exposition of policies that the panel believed should animate its application. The Fifth Circuit observed that "in bankruptcy 'almost everyone loses something.'"[21] The court then voiced the fear that "[l]itigation of professionals' fee applications may become substantial, costly and time-consuming if counsel can be compensated for their self-interested efforts."[22]

Next, the court rejected Baker Botts' attempt to analogize fees for the defense of fee applications to procedures under federal fee-shifting statutes. It deemed the equities "quite different" in bankruptcy cases, because "[n]o side wears the black hat for administrative-fee purposes."[23] Presumably, its point was that under most fee-shifting statutes, the party recovering fees has already prevailed on the merits of the underlying action that gave rise to such fees.

In the same paragraph, the court again aired concerns about "[t]he perverse incentives that could arise from paying the bankruptcy professionals to engage in satellite fee litigation."[24] Such statements reflect the court's suspicion that if they could be compensated for it, bankruptcy professionals would seize upon the opportunity to engage in satellite fee litigation as a means of somehow inflating any ultimate fee revenue. In this practitioner's experience, however, this thinking ignores the reality that fee objections are generally made before professionals have been paid and have the effect of delaying payment until they are resolved (*e.g.*, the investment banker that seeks to recover its transaction fee upon consummation of a sale).

When confronted with the law firms' arguments that their inability to recover fees for the defense of their fee applications would dilute their effective billing rates, as supported by the indisputable proposition that "[t]he Bankruptcy Code plainly intended to erase the 'economy of the estate' rule under pre-existing law,"[25] the court retorted that "[t]he claim for comparability is easily made but difficult to analyze."[26] Elaborating further, the court deemed the $5 million of defense fees as insufficiently sizeable in relation to the overall fee award to warrant an examination of whether awarding fees for the defense of the fee application would be unfairly dilutive.

The court then invoked the American rule under which litigants each normally bear their own costs, absent bad faith or other abuses. Although they acknowledged that the Bankruptcy Code's compensation provisions had been substantially overhauled from those in the Bankruptcy Act, the panel viewed these revisions as supporting its position that the American rule still applies. In the court's logic, the only way that Congress could have meant for § 330(a) to depart from the American rule is if § 330(a) had been further updated in 1994 to expressly allow compensation to professionals for defense of their fee applications.[27]

Finally, the court addressed the concern that the failure to compensate professionals for the successful defense of fee applications would encourage tactical objections and create disincentives for competent professionals to handle bankruptcy cases. The court returned to an abiding theme of its opinion — the perception that bankruptcy professionals "enter into a conspiracy of silence with regard to contesting each other's fee applications."[28] According to the Fifth Circuit, bankruptcy judges already have the tools to quell the tactical misuse of fee objections by "practicing vigilance and sound case management" to "thwart punitive or excessively costly attacks on professional fee applications."[29]

## *ASARCO*'s Implications

The *ASARCO* approach holds sway in the Fifth Circuit and (possibly) the Eleventh Circuit, as well as in a few lower courts. However, if the Supreme Court embraces the view that § 330(a) never permits compensation for the defense of fee applications, then bankruptcy professionals will need to adapt their practices to the new reality that they will normally not be compensated for successfully defending their fee applications.

The *ASARCO* court proffered two suggestions to professionals: They can anticipate the possibility of not being reimbursed for defending fee applications by (1) adjusting upward their hourly rates and (2) more thoroughly documenting their fee applications.[30] However, such ad hoc rate modifications are not a viable solution at a time when the U.S. Trustee Program has implemented revised standards requiring professionals in larger chapter 11 cases "to establish that the compensation sought is reasonable as compared to the market measured by the billing practices of the applicant and its peers for bankruptcy and non-bankruptcy engagements," and has a stated policy to "ordinarily object to fees that are above the market rate for comparable services."[31]

Moreover, requiring professionals to prophylactically more thoroughly document fee applications will simply increase the cost to estates of fee application preparation across the board. It is unlikely to meaningfully reduce objections, which in the author's experience are almost always tactically motivated, or eliminate costly proceedings to resolve them.

19 317 F.3d at 929.
20 *ASARCO*, 751 F.3d at 300.
21 *Id.* at 300 (quoting *Grant*, 908 F.2d at 882).
22 *Id.*
23 *Id.* at 300-01.
24 *Id.* at 301.
25 *Id.* (quoting *In re Pilgrim's Pride Corp.*, 690 F.3d 650, 654-55 (5th Cir. 2012)).
26 *Id.*
27 *Id.* at 301-02.
28 *Id.* at 302 (quoting *In re Consolidated Bancshares Inc.*, 785 F.2d 1249, 1255 (5th Cir. 1986)).
29 *Id.* at 302.
30 *Id.* at 301, n.7.
31 "Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed under United States Code by Attorneys in Larger Chapter 11 Cases," 78 *Fed. Reg.* 116, at 36250 (June 17, 2013).

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One option that might remain open is to seek approval under § 328(a) at the time of retention of engagement terms authorizing a professional to seek reimbursement of fees and expenses incurred in successfully defending its fee application. However, if the Supreme Court reads § 330(a) to *per se* preclude recovery of such fees and expenses, this workaround might be vulnerable. It has been held that the determination under § 328(a) of what terms and conditions of employment are reasonable must be "made against the backdrop of the statutory compensation scheme of sections 330 and 331."[32] Whether reference to the § 330 backdrop means that § 328(a) approval of such employment terms would be precluded remains to be seen. abi

32 *In re C & P Auto Transp. Inc.*, 94 B.R. 682, 686 (Bankr. E.D. Cal. 1988). *But cf. In re Fed. Mogul-Global Inc.*, 348 F.3d 390, 397 (3d Cir. 2003) (observing that language of § 328(a) "may easily be interpreted to mean that the Court may approve the employment of a professional on any terms and conditions that the Court finds necessary to satisfy the requirement of reasonableness").