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Update on Business Bankruptcy Legal Fees and Professionalism

By Michael L. Cook

"'Staggering' legal fees in Boy Scouts Bankruptcy Case." So read the title of an article in *The New York Times* on May 11, 2021. According to the reporter, a "lawyer negotiating a resolution to the multi-billion dollar bankruptcy filed by the Boy Scouts of America billed $267,435 in a single month. Another charged $1,725 for each hour of work. New lawyers fresh out of law school have been billing at an hourly rate of more than $600." The bankruptcy judge presiding over the case has called the fee totals "staggering," said the reporter. On the same day, May 11, another bankruptcy judge in the Southern District of New York, cut the fees of a putative debtor's counsel from $524,051 to $40,798, a reduction of more than 90%. *See*, *In re Navient Solutions, LLC*, 2021 WL 1885915 (Bankr. S.D.N.Y. May 11, 2021).

Are these recent developments new? Newsworthy? Unique? They are none of the above. A review of recent cases shows that poor billing judgment and unreasonable billing have been with us for decades.

Poor Billing Judgment

Counsel for a putative debtor who succeeded in fending off an involuntary bankruptcy petition against their client applied to the bankruptcy court for their fees and costs in the *Navient* case. Applying Bankruptcy Code §303(i)(1), which permits the recovery of "a reasonable attorney fee," the court found that "the amount of fees and expenses [the debtor] seeks to recover from the work of [its two law firms] is not reasonable." *Id*. at 2. First, said the court, the debtor's "motion to dismiss the involuntary petition was overstaffed with too many lawyers and paralegals from two law firms. 2021 WL 1885915, at 8. "[One firm] staffed this matter with five partners, four associates and one paralegal," with the "five partners [having] billed nearly 200 hours over a month." *Id*. Second, the court found a "duplication of services between" the two law firms. "Six lawyers on [one firm's] team (including four partners), and all three lawyers on [another firm's] team (including one partner and one counsel) attended" the hearing on the motion to dismiss. Further, reasoned the court, "the descriptions of services" by the two firms were "insufficiently detailed." *Id*. One firm omitted the "lawyers' and paralegals' titles," with no "summary for the categories of fees." *Id*. "Critically, there [were] numerous instances of impermissible block billing, and excessive hours spent on some services, including phone conferences. [One firm] block-billed 446 hours totaling $441,235.00 — approximately 84% of the total fees requested." *Id*. In concluding, the court found that it could reduce the fees "as a practical means of trimming fat from a fee application," reason-

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ing that a reduction was appropriate "for vagueness, inconsistencies, and other deficiencies in the [bills]." *Id*. In sum, the court cut the fees "for numerous vague [time] entries" and "overstaffing." *Id*. *See also, Zolfo, Cooper & Co. v. Sunbeam Oster Co.*, 50 F.3d 253, 259-62 (3d Cir. 1995) (fee request cut because of "excessive billing" at "high end," "duplicated effort, … too many high-level personnel, and … an incomplete fee application.").

The seminal case for fee-churning is *Taxman Clothing Co.*, 49 F.3d 310 (7th Cir. 1995). In that case, a bankruptcy trustee's special counsel was ordered to disgorge approximately $78,000 of interim fees for having breached his fiduciary duty to his client. According to the court, the lawyer pursued litigation that any reasonable attorney would have known was not cost effective. The trustee's lawyer, "as part of his fiduciary duty," must show "care, diligence, and skill in deciding which claims to prosecute, and how far." *Id*. at 315. The lawyer here had received a total of $85,000 in fees but recovered only $44,000 for the debtor's estate before he had to disgorge $78,000 "under fiduciary principles." 49 F.3d at 312, 316.

The Eastern District of New York recently dismissed an appeal from a bankruptcy court order that had directed the debtor's counsel to disgorge fees paid for a second failed chapter 13 filing because the fees were unreasonable. *In re Pugh*, 2020 WL 2836823 (E.D.N.Y. May 31, 2020). According to the court, Bankruptcy Code §329(b) (judicial review of pre-bankruptcy fees for reasonableness) gave the bankruptcy court the "ability to prevent over-reaching attorneys from taking advantage of desperate" debtors. The bankruptcy court had not abused its discretion, said the district court, because there was "little, if any, reason to believe that a second attempt" at bankruptcy "would be successful." Moreover, even the debtor's "purported satisfaction" with the lawyer's services did not preclude judicial "scrutiny."

The Tenth Circuit, at the beginning of this year, affirmed a bankruptcy court's reduction in fees sought by counsel for a Chapter 7 trustee. According to the court, the trustee and counsel failed to exercise "good billing judgment" by including requests for services that were "unnecessary, duplicative and excessive." *In re Reynolds*, 835 Fed. Appx. 395, 397, 400 (10th Cir. Jan. 6, 2021). The trustee and counsel "were not reasonably diligent in valuing [property] before incurring substantial fees trying to sell [it]." Large parts of counsel's services "were not reasonably likely to benefit the estate under … §330(a)(4)(A)." According to the district court in the case, a "normal client would not … pay for services it found to be unnecessary, duplicative, unreasonable, or without benefit." 2019 WL 4645385 (D. Utah Sept. 24, 2019).

Appellate courts ordinarily review bankruptcy court fee awards "for abuse of discretion" by the bankruptcy court, explained the Tenth Circuit. That review is ordinarily "highly deferential", however, because the bankruptcy judge is in the "best position to … make the delicate judgment calls." *Id*. at 398. In this case, the Court of Appeals refused to "substitute" its "judgment" for that of the bankruptcy court. "Mismanagement of the estate" has to be considered when determining the reasonableness of any legal fee. "[O]ver-lawyering of an elementary Chapter 7 case … rendered the estate [here] administratively insolvent." *Id*. at 400.

Poor Judgment

The Fifth Circuit reversed and remanded the lower court's dismissal of a client's suit against its counsel for "breach of fiduciary duty" in misrepresenting the counsel's share of settlement proceeds.

In re ABC Dentistry P.A., 978 F.3d 323 (5th Cir. Oct. 28, 2020). At the time of a hearing on court approval of a settlement, the client could not have known that "his attorney lied to him" about the allocation of fees, inducing him "not to oppose or appeal [the] bankruptcy's proposed [fee] allocations." *Id*. at 326. The lawyer's claim preclusion or *res judicata* argument could not have applied to this plaintiff because it was "not until *after* the … hearing that [the client] could have discovered" his counsel's lies. *Id*. According to the Fifth Circuit: "Cause, not self. That is the sworn duty of every member of the legal profession — to subordinate their own interests to those of their clients …. [Counsel denied any fraud.] For the sake of the reputation of the legal profession (such as it is), we hope that this is so [after trial]." *Id*. at 324, 326.

Conclusion

Cynics will attribute these egregious cases to simple greed. They might cite the commencement speech of convicted felon Ivan Boesky: "Greed is all right …. Greed is healthy. You can be greedy and still feel good about yourself." Commencement Address, Berkeley, California, May 18, 1986.

They can also accept the word of a successful business bankruptcy accountant that large reorganization cases are an "LBO — large billing opportunity."

Greed may have caused some of the lawyers' problems in these cases. But the larger problem is one of judgment.

The lead lawyer on any engagement should assume the position of the client. Only then would active, participating lawyers appear at a court hearing for billing purposes. If the lead lawyer wants junior lawyers to observe the hearing for training purposes, the client should not be charged for that lawyer's education. This is not to say that a junior lawyer can have no beneficial role, though. A junior lawyer can, and often does, provide value to the client by assisting a senior lawyer with evidentiary and substantive legal matters during a hearing or trial. But that help should be supported by time records. "Attendance at court hearings" in time records will surely fail any test.

What courts have been doing in cutting legal fees is a mirror of what savvy clients have been doing over the past few years. They may not mind paying $1,500 per hour for the services of an effective, experienced senior lawyer. Billing for the training of an inexperienced lawyer who contributes no value to the engagement, however, no longer works. Nor will overstaffing or unnecessary duplication of services.

Judicial criticism of lawyer's overbilling is nothing new. *See e.g.*, *Taxman Clothing; Zolfo Cooper*, *supra*. As a matter of fairness, bankruptcy judges should give counsel advance warning of their views, either at the outset of a case, in court rules or published decisions. *See*, *e.g.*, *In re Bank of New England Corp.*, 134 B.R. 450 (Bankr. D. Mass. 1991). ("As a guide to the professionals … this opinion will … describe the basic rules [to] be followed in dealing with [fee] applications.").

Professionalism — subordinating your interests to that of the client — should remain the lawyer's standard. We always knew, or should have known, that "money-getting" visions of our profession have been around for decades. But maybe, picking our way through temptation, we will find that we can change this perception.

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