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Delaware Bankruptcy Court Rejects Attempt to Indemnify Committee Counsel for Costs of Defending Fees

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April 23, 2016 - In *In re Boomerang Tube, Inc.*,^[1] the United States Bankruptcy Court for the District of Delaware refused to approve a proposed retention application that would have required the bankruptcy estate to reimburse counsel for the committee of unsecured creditors for fees and expenses the counsel incurred in any successful defense of their fees in the case. The Bankruptcy Court ruled that such an arrangement was impermissible under the Bankruptcy Code and in contravention of the Supreme Court's 2015 ruling in *Baker Botts L.L.P. v. ASARCO LLC*.^[2] The Bankruptcy Court's decision poses implications for professionals faced with the prospect of defending their fees in bankruptcy cases, who may now be compelled to shoulder the expenses of a potential fee defense even if they have negotiated contractual provisions for the reimbursement of such fees.

In *Boomerang Tube*, the Official Committee of Unsecured Creditors (the "Committee") retained counsel ("Committee Counsel") pursuant to a retention agreement, which provided that Committee Counsel would be indemnified for any fees and expenses incurred while successfully defending potential challenges to their fees. The Committee sought approval of the retention agreement pursuant to section 328(a) of the Bankruptcy Code.

The U.S. Trustee (the "UST") objected to the fee defense provisions on three principal grounds. First, the UST argued that the provisions were barred by the ruling in *ASARCO*, in which the Supreme Court held that a law firm cannot recover fees from a bankruptcy estate for its defense against an objection to its fees. Second, the UST argued that section 328(a) of the Bankruptcy Code did not create an exception to the "American Rule" that requires each litigant to pay its own attorney's fees. Third, the UST contended that the proposed fee defense provisions were impermissible under section 328(a) because they were unreasonable and sought to compensate Committee Counsel for work outside the scope of their employment.

In response, the Committee first argued that *ASARCO* was distinguishable because it held only that section 330(a) of the Bankruptcy Code did not contain an express exception to the American Rule, whereas the Committee sought approval of the proposed fee defense provisions pursuant to section 328(a). Second, the Committee asserted that the Supreme Court's ruling in *ASARCO* did not preclude a contractual exception to the American Rule. Third, the Committee contended that the proposed fee defense provisions were permissible under section 328(a), citing numerous bankruptcy cases in which indemnification provisions for successfully defending fees were approved.

The Bankruptcy Court rejected each of the Committee's arguments and denied the Committee's request for approval of the fee defense provisions in Committee Counsel's retention agreement. First, the Bankruptcy Court found that although section 328(a) of the Bankruptcy Code provided an exception to section 330, it did not authorize the fee defense provisions at issue because section 328(a) did not contain the "specific and explicit" statutory exception to the American Rule required under the *ASARCO* ruling.

Second, the Bankruptcy Court acknowledged the possibility of a contractual exception to the American Rule, but concluded that the proposed fee defense provisions were nonetheless impermissible because they were inconsistent with the Bankruptcy Code. The Bankruptcy Court observed that the retention agreement was a contract between the Committee and Committee Counsel that called for a third party—the bankruptcy estate—to pay the Committee Counsel's defense costs. Because the retention agreement could not bind a non-party to the agreement, the Bankruptcy Court held the proposed fee defense provisions to be unenforceable. The Bankruptcy Court also noted that retention agreements in bankruptcy proceedings are not simply contractual matters, but are also subject to objections by other parties and ultimately require court approval in accordance with the provisions of the Bankruptcy Code, regardless of the terms of the agreement.

Third, the Bankruptcy Court considered whether, even if *ASARCO* did not preclude the proposed fee defense provisions, they could be approved under section 328(a). The Court agreed with the UST that the provisions did not constitute "reasonable terms and conditions of employment" for Committee Counsel under section 328(a), because defending their own fees would be a service performed by Committee Counsel only for their own interests, not for the Committee itself. The Bankruptcy Court was also unpersuaded by the Committee's reference to similar indemnification provisions that were approved in other cases. The cases the Committee relied upon predated the *ASARCO* decision, which expressly rejected the consideration of such market factors in determining whether defense fees can be recovered.

Boomerang Tube presents a warning for all professionals involved in bankruptcy cases—not solely committee counsel—in drafting fee defense provisions in a retention agreement. The Bankruptcy Court noted that it would deny approval of a retention agreement "filed by any professional under section 328(a)—including one retained by the debtor" that shifted fees incurred by the professional in defending fee objections.[3] Other courts may follow this reasoning, and bankruptcy professionals may attempt other methods of circumventing *ASARCO*'s restrictions.

Footnotes

[1] *In re Boomerang Tube, Inc.*, No. 15-11247, 2016 WL 385933 (Bankr. D. Del. Jan. 29, 2016).

[2] *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015).

[3] *In re Boomerang Tube*, 2016 WL 385933 at *8 n.6.

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