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A Primer on 11 U.S.C. § 328(a) and its use in Alternative Billing Methods in Bankruptcy

by Robert J. Landry, III* and James R. Higdon**

I. INTRODUCTION

Compensation of attorneys and professionals1 in the bankruptcy field is one of the most written about areas in bankruptcy law. Professionals, both familiar and unfamiliar with the mandates of the Bankruptcy Code2 and Federal Rules of Bankruptcy Procedure,3 are having an increasingly difficult time obtaining approval for the envisioned compensation. Problems generally do not arise for debtors' attorneys in the run-of-the-mill Chapter 7 case or Chapter 13 case. Flat fees are charged in most of these cases, and applications to employ debtors' attorneys...

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attorneys are not filed. Therefore, retention orders are not entered.\(^4\) However, outside the run-of-the-mill Chapter 7 or 13 case, in Chapter 11 cases, or when an attorney or professional is hired for a special purpose under section 327(e), problems regarding the particular compensation may arise.

In the past, most courts used a traditional fee arrangement based upon reasonable hours and a reasonable rate, commonly referred to as the "lodestar"\(^5\) approach, when approving fees. Because the lodestar method is not always the desired fee arrangement,\(^6\) professionals are increasingly attempting to use various fee arrangements,\(^7\) which in the past were not commonly used by bankruptcy professionals. However, in the bankruptcy arena, these nonlodestar fee arrangements are confusing, inconsistently applied, and potentially dangerous to professionals.

Section 328(a) is a useful tool with alternative fee arrangements. Section 328\(^8\) allows professionals to obtain court approval of the

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4. In Chapter 7 cases, the debtors' attorneys' only obligation is to make the appropriate disclosures required by section 329 and Rule 2016. There is no statutory authority for the entry of retention orders for Chapter 7 debtors' attorneys.

Likewise, in most Chapter 13 cases an application to employ the debtor's attorney is not filed. Thus, the entry of a retention order will not come into play. The debtors' attorney's only obligation is to make the appropriate disclosures required by section 329 and Rule 2016. Furthermore, in Chapter 13 cases, most courts have implemented local rules or procedures that set the initial fees. This in turn allows debtors' attorneys to predict with relative accuracy their fee. See In re Shamburger, 189 B.R. 965, 973 (Bankr. N.D. Ala. 1995); In re Watkins, 189 B.R. 823, 832 (Bankr. N.D. Ala. 1995); In re Pineloch Enters., 192 B.R. 675, 677 (Bankr. E.D.N.C. 1996).

However, it appears that, pursuant to the concurrent powers the Chapter 13 debtor has with the trustee under section 1304, the debtor has the power to employ its attorney under section 327, just as the trustee, and perhaps the debtor, is required to seek authority to employ an attorney. The authors have been unable to find an answer to explain why applications to employ Chapter 13 debtors' attorneys are not filed and retention orders not issued. The Chapter 13 attorney will receive compensation under section 330, which seems to require that professionals be employed under section 327.

5. See infra notes 25-26 and accompanying text. Outside of statutory fee cases, attorneys often use a variation of a lodestar method of billing clients by charging their clients an hourly rate, i.e. "time-based billing."


7. See infra note 119 and accompanying text.

8. 11 U.S.C. § 328(a) provides:

The trustee, 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
particular terms and conditions of employment at the beginning of a case. The preapproval of the terms and conditions under section 328 minimizes problems at the time the application for compensation is filed because bankruptcy courts must apply the terms of employment as approved, unless the terms prove to have been improvident in light of developments unanticipated at the time of entry of the retention order.\(^9\) This provides professionals a tremendous benefit: predictability of their compensation. However, professionals must properly seek and obtain a retention order under section 328(a) at the outset of their employment to enjoy the benefit of pre-approved terms and conditions.

The difficulty is that many lawyers and judges do not understand, or even realize, the impact\(^{10}\) of the useful tool provided in section 328(a). This generalization does not apply to all jurisdictions or bars; however, at the very least it appears that there is great confusion regarding the impact of section 328(a), particularly at the time of the application for compensation. This Article analyzes the history of section 328(a), its use and effect, and various alternative fee arrangements which have developed in bankruptcy practice.

II. EMPLOYMENT AND COMPENSATION OF PROFESSIONALS GENERALLY

To insure independence and protect the estate, section 327 requires that all employed professionals be approved by the court.\(^{11}\) To obtain 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.

9. See infra notes 63-94 and accompanying text.

10. The authors have not performed a scientific study as to the number of attorneys and courts using section 328(a). However, based on first-hand experience, the lack of a body of comprehensive case law correctly using section 328(a), the failure of the leading bankruptcy treatises to fully analyze this section, and few, if any, articles carefully analyzing it, section 328(a) is not widely used. When it is used, it does not appear to provide the fullest benefit for the professional, estate, and the court. At least one other commentator has recognized the infrequency with which section 328(a) is used. See Craig B. Cooper, The Priority of Postpetition Retainers, Carve-Outs, and Interim Compensation Under the Bankruptcy Code, 15 CARDOZO L. REV. 2337, 2343 (April 1994).

11. See, e.g., In re Rheam of Ind., Inc., 133 B.R. 325, (E.D. Pa. 1991), on remand 137 B.R. 151, vacated 142 B.R. 698 (E.D. Pa. 1992) (advance approval of professional is required to allow court to ensure the integrity, experience, and competence of the professional seeking to be employed); In re Weibel, Inc., 176 B.R. 209 (B.A.P. 9th Cir. 1994) (professional must show competence to act on behalf of estate and that such professional is disinterested); In re Sky Valley, Inc., 135 B.R. 925, 936 (Bankr. N.D. Ga. 1992) (professional must be approved by court if playing role in reorganization of estate).
approval, an application must be filed by the trustee, debtor in possession, or the committee, setting forth various details pursuant to Rule 2014. The professional seeking employment has the burden of making a complete and candid disclosure, in a verified statement, of all facts pertinent to the court’s decision to approve employment. It is the responsibility of the professional to make sure that all relevant connections have been brought to the court’s attention because it is only after complete disclosure that the court can make an informed decision regarding the professional’s proposed employment.

Based upon the application and verified statement, the court applies the standard set forth in section 327 to determine if the particular professional employment should be allowed. The standard applied is

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12. 11 U.S.C. § 327 provides for the employment of professionals by the trustee. Section 1102 provides the Chapter 11 debtor the same power as that held by the trustee. Section 1103 provides committees the authority to employ professionals.

13. Rule 2014 provides:

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 be filed and, unless the case is a chapter 9 (sic) municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. 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. The application shall be accompanied by a verified statement of the person to be employed setting forth the person’s connections with the debtor, creditors, or 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.

14. See, e.g., Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994) (quoting In re Huddleson, 120 B.R. 399, 400-01 (Bankr. E.D. Tex. 1990) (“The case law is clear that the burden of disclosure is upon ‘the person making the statement of qualification for employment to come forward with facts pertinent to eligibility and to make candid and complete disclosure.’”)); In re Prudhomme, 152 B.R. 91, 1105 (Bankr. W.D. La. 1993) (The court held the applicant has the burden of disclosure.).


17. 11 U.S.C. § 327 provides in part:

(a) Except as otherwise provided in this section, the trustee, with the court’s approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to
The professional and the court have two alternatives in establishing the fee arrangement.\textsuperscript{20} One approach is to request a retention order under section 328 that fixes the terms and conditions of the employment. The other approach is to request approval to be employed, reserving compensation issues to the time of filing the fee application pursuant to Rule 2016(a)\textsuperscript{21} and sections 330 or 331.\textsuperscript{22} In such situations, at the time of filing the fee application, the court applies section 330 to award a reasonable amount of compensation\textsuperscript{23} and reviews the other factors in section 330(a)(3)(A)-(E) to assure they have been complied with. These factors essentially are a codification of the lodestar calculation, which is the primary method used to determine the reasonable the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

\textbf{18.} Section 327(a) sets forth the standard to determine if the applicant can be employed as "general" counsel to the trustee or debtor-in-possession.

\textbf{19.} Section 327(e) sets forth the standard to determine if the applicant can be employed as "special" counsel to the trustee or debtor-in-possession.

\textbf{20.} \textit{See In re National Gypsum Co.}, 123 F.3d 861, 862 (5th Cir. 1997) ("The court must therefore set the compensation award either according to § 328 or § 330.").

\textbf{21.} Rule 2016 provides, in pertinent part:

an entity seeking interim or final compensation for services, or reimbursement of necessary expenses . . . shall file an application setting forth a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amount requested . . . . The requirements of this subdivision shall apply to an application for compensation for services rendered . . . .

\textbf{22.} 11 U.S.C. § 330 provides that "the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103-(A) reasonable compensation for actual, necessary services rendered . . . ." (signifying application for compensation following employment). Section 331 provides for interim compensation to persons employed under sections 327 or 1103.

\textbf{23.} \textit{In re Central Fla. Metal Fabrication, Inc.}, 207 B.R. 742, 748 (Bankr. N.D. Fla. 1997) ("To be awarded in a bankruptcy context, attorney fees must not only be reasonable, they must also meet the criteria set forth in Section 330(a).").
compensation in a bankruptcy case,\(^24\) and is usually the starting point for courts in crafting any appropriate attorney fee award.\(^25\)

Which approach is used depends greatly on the particular bankruptcy court where the case is pending. As with much of bankruptcy practice, the particular procedures and practices regarding the employment and compensation of professionals is localized. Therefore, professionals should always consult local rules or policies prior to filing an application to be employed.

III. Employment and Compensation Under Section 328(a)

A. History of Section 328(a)

Prior to section 328, there was no mechanism for court approval of the compensation at the time of such approval of professional's employment. Compensation was governed by former Bankruptcy Rule 219(c)(1), which provided that a professional who rendered services to the bankrupt estate was entitled to reasonable compensation. Contracts for employment on a percentage fee basis between a trustee in bankruptcy and an

\(^{24}\) See, e.g., In re Boddy, 950 F.2d 334 (6th Cir. 1991); Grant v. Schumann Tire & Battery Co., 908 F.2d 674 (11th Cir. 1990); In re Manoa Fin. Co., 853 F.2d 687 (9th Cir. 1988); In re Lawler, 807 F.2d 1207 (5th Cir. 1987); Boston & Maine Corp. v. Moore, 776 F.2d 2 (1st Cir. 1985); Herman v. Levin, 772 F.2d 1150 (4th Cir. 1985); Lindy Bros. Builders v. American Radiator & Standard Sanitary Corp., 487 F.2d 161 (3rd Cir. 1973).

\(^{25}\) See, e.g., Loranger v. Stierheim, 10 F.3d 776, 781 (11th Cir. 1994); Central Fla. Metal, 207 B.R. at 748 ("The starting point in crafting an appropriate attorney fees award is to multiply a reasonable hourly rate by the number of hours worked, thus arriving at the 'lodestar.'").

Although lodestar is the primary method for awarding fees in bankruptcy and is usually the starting point, there are several inherent problems with the lodestar compensation method. The biggest problem by far is uncertainty. First, the court may not approve the hourly rate envisioned by the professional. In fact, the court may determine that the hourly rate should be significantly lower than counsel anticipates. This leads to a reduction in fees. Conversely, the court may determine the hours spent working on the case were not reasonable and reduce them accordingly.

Second, problems can arise with the lodestar method in situations wherein the hourly rate, multiplied by reasonable hours, will not be sufficient to induce counsel to represent the case. This is especially true in cases related to the bankruptcy wherein counsel operates in courts other than the bankruptcy courts. In the private market, these types of cases are almost routinely handled on other types of fee arrangements, namely, contingency-fee arrangements.

Third, from an administrative point of view for the bankruptcy courts, "setting fees in large cases pursuant to the lodestar hybrid" is burdensome without some assistance, and the lodestar method is "questionable in its efficacy." In re Home Express, Inc., 213 B.R. 162, 165 (Bankr. N.D. Cal. 1997).
attorney were often invalidated. The relevant inquiry was not whether the fee contract was per se invalid, but whether the compensation provided by the agreement was reasonable under former Rule 219.

The guiding principles under the old rule were conservation of the estate and economy of administration. Under this standard, the courts set attorney fees based on notions of "equity and fairness to creditors and on conservation of the estate." The reasoning was that professionals employed under section 240 of the Bankruptcy Act were "public officers" and thus, not permitted to be compensated on the same scale as those privately employed. Thus, the bankruptcy judges were to award fees "at the lower end of the spectrum of reasonableness." The effect was to allow attorney fees only. "These principles, however, discouraged practitioners from entering the bankruptcy field, where they would have earned substantially less than in other areas of practice." This, in turn, led to a perceived stigma that "only less qualified counsel in the bankruptcy bar worked for debtors due to the reduced compensation." As a result, estates were ill-served by less-able bankruptcy specialists, and the costs of inefficient management were passed on to creditors. "In 1978, Congress enacted 11 U.S.C. § 330(a) and expressly provided that compensation should be reasonable and at least in part based on the cost of comparable services."

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28. See, e.g., In re Penn-Dixie Indus., 18 B.R. 834, 838 (S.D.N.Y. 1982); In re River Landings, Inc., 180 B.R. 701, 704 n.4 (Bankr. S.D. Ga. 1995) (citing In re Manoa Fin. Co., 853 F.2d 687, 689 (9th Cir. 1988)). See also In re Farley, Inc., 156 B.R. 203, 210 (Bankr. N.D. Ill. 1993) (The court noted that "[p]rior to the enactment of [the Bankruptcy Code], economy of administration was the paramount consideration in determining attorney fee awards.").
30. See River Landings 180 B.R. at 704 n.4 (citing Manoa, 853 F.2d at 689).
31. Farley, 156 B.R. at 210 (quoting In re United States Golf Corp., 639 F.2d 1197, 1201 (5th Cir. 1981) (quoting In re First Colonial Corp., 544 F.2d 1291, 1299 (5th Cir. 1977))).
33. Benassi, 72 B.R. at 47.
34. Hunt's Health Care, 161 B.R. at 975 n.1 (citing In re Drexel Burnham Lambert Group, 133 B.R. 13 (Bankr. S.D.N.Y. 1991)).
Congress abandoned the economy of administration of the estate standards in enacting the Bankruptcy Code and courts are "no longer bound by pre-Code notions of frugality and economy in fixing fees." The new standard served two important purposes, namely, that compensation be fair and reasonable. In order to not deter "competent counsel from entering the bankruptcy area, attorneys should receive in bankruptcy matters what they would receive on the open market." It is in accord with this section 330(a) market approach to compensation that different fee arrangements were expressly sanctioned by section 328(a).

B. Application for Employment Under Section 328(a)

1. Fixing Terms is Discretionary. The starting point for any award of nonlodestar fee arrangements is the basic premise that there is no authority requiring a court to approve fee arrangements simply because the professional anticipated, or even contracted with the client, on how compensation would be computed. However, section 328(a) provides a procedural mechanism for professionals seeking court authorization of the terms of compensation at the time of the application for approval of employment.

"In sharp contrast with the old Bankruptcy Act, section 328(a) now authorizes the court to preapprove a wide variety of employment arrangements."
arrangements between the attorney and trustee." At least two courts have held that courts are required to approve the proposed terms and conditions of a professional's employment at the front end as part of the application for employment, rather than defer the approval of the terms and conditions pending the court's normal application and allowance procedures concerning fees.

The reasoning of these courts defies the basic tenets of statutory construction. For instance, in In re Dividend Development Corp., the court reasoned that section 328 imposes a condition on a court entering a retention order approving a professional's employment under section 327. The court further reasoned that since section 328 was a necessary condition, a reasonableness analysis of the fee arrangement was required at the beginning of the case. Section 328(a) provides in pertinent part:

The trustee, . . . 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.

Section 328 clearly states that the trustee may employ professionals on any reasonable terms, provided the trustee obtains court approval. The statute does not mandate that the court approve any terms or conditions. The statute simply provides the trustee the procedural mechanism to seek such approval from the court. If such approval is not sought, there is no requirement that the court consider the particular terms or conditions at the time of the employment application, much less a requirement that it approve the terms and conditions of the proposed employment as a condition to the employment.

The court's second conclusion in Dividend, that the authorization in section 328 to modify fees if such terms prove "to have been improvident

41. Benassi, 72 B.R. at 47; see also In re Olympia Holding Corp., 176 B.R. 962, 965 (Bankr. M.D. Fla. 1994) ("In contrast to pre-code law, § 328 allows the court to pre-approve various types of employment arrangements including contingency agreements.") (citing § 328(a); In re Benassi, 72 B.R. 44 (D. Minn. 1987))).
42. See, e.g., In re Heritage Mall Assocs., 184 B.R. 128, 131 (Bankr. D. Or. 1995) ("This court should not have approved the employment of the firm without approving the fee agreement that had been entered into between the debtors and the firm as reasonable."); In re Dividend Dev. Corp., 145 B.R. 651, 655 (Bankr. C.D. Cal. 1992).
44. Id. at 655.
45. Id.
46. 11 U.S.C. § 328(a).
in light of developments not capable of being anticipated" at the time of fixing the terms and conditions, which anticipates the court making a reasonableness determination at the beginning of the case, is partially correct. If the trustee seeks approval of the terms and conditions at the beginning of the professional's employment, the court will have to make some type of a reasonableness determination at the beginning of the case. However, this has no impact on any requirement of the court to enter section 328(a) retention orders. Such orders are in the court's discretion. There is no requirement in the Code dictating that courts fix the terms and conditions of the employment of any professional.

Thus, to read such a requirement in the Code is judicial legislation.

2. Retention Order with Fixed Terms. It is critical for professionals who wish to afford themselves of the benefits of preapproved terms under section 328(a) to obtain a retention order expressly authorizing the employment under the desired terms prior to the services being rendered. This will usually require expressly asking for such an order in the employment application. In some districts, such orders are entered routinely; however, this is not a universal practice.

Professionals should beware of retention orders which mention section 328(a) but do not set out specific terms or approve the specific terms requested. Without a retention order expressly authorizing the employment under specific terms and conditions under section 328(a), an order with boilerplate language approving employment only establishes that

47. Dividend Dev. Corp., 145 B.R. at 655 (interpreting the language of § 328(a).
49. However, it should be noted there is one instance when the terms and conditions must be set. Rule 6005 provides that "[t]he order of the court approving the employment of an appraiser or auctioneer shall fix the amount or rate of compensation." This provision is logically read to require that when the professional seeking employment is an auctioneer or appraiser, the court must enter the retention order pursuant to section 328(a). The court is not required to approve the terms as requested; however, the retention order must fix the terms and conditions. The exact terms and conditions will be set by the court's determination of what is reasonable.
50. See, e.g., In re Olympia Holding Co., 176 B.R. at 965 ("[Section] 328 must apply when the court approves a fee arrangement prior to services being rendered.") (citing Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955 (9th Cir. 1991); In re Benassi, 72 B.R. 44)); In re Donaldson, No. C-95-4528 FMS, 1996 WL 161677, at *2 (N.D. Ca. Apr. 2, 1996) (citing Puget, 924 F.2d at 960) ("Section 328(a), therefore, 'only applies where the court has validated a previous fee arrangement . . . .").
51. Such standard orders are routinely entered. For example, the bankruptcy judge in the Western District of Pennsylvania entered such a standard order authorizing an applicant's retention which stated that "debtors in profession[ ] be and hereby are authorized to retain the firm of [Zolfo, Cooper & Co.] to perform the services as set forth in the foregoing Motion and Affidavit of Frank John Zolfo." Zolfo, Cooper & Co. v.
the attorney has met the specifications of section 327 and is allowed to
represent the estate. Such an order, however, does not bind a court to
the particular terms and conditions of compensation recited in an
application for employment or otherwise anticipated by the applicant.\textsuperscript{52}
In the case of \textit{In re C & P Auto Transport, Inc.},\textsuperscript{53} the court noted the
importance of precise language in the order authorizing the profession-
al's employment:

If the order does not expressly and unambiguously state specific terms
and conditions (e.g., specific hourly rates or contingency fee arrange-
ments) that are being approved pursuant to the first sentence of
section 328(a), then the terms and conditions are merely those that
apply in the absence of specific agreement. That leaves the court free
to apply lodestar rates unfettered by the strictures of the second
sentence of 328(a) . . . .\textsuperscript{54}

Sunbeam-Oster Co., 50 F.3d 253, 262 (3rd Cir. 1995).
\textsuperscript{52} Id. See also \textit{In re Yermakov}, 718 F.2d 1465 (9th Cir. 1983) (The contingent fee at
issue and argued by counsel to be approved was executed more than a year before the
bankruptcy petition was filed, and was never preapproved by the bankruptcy court. The
fee award was calculated under the general provisions of section 330; sections 327 and 328
were not implicated); \textit{In re Donaldson}, No. C-95-4528 FMS, 1996 WL 161677, at *2
("Pursuant to 11 U.S.C. Section 328(a), a court has the discretion to deviate from the terms
of employment and award a reasonable amount of attorney fees where the terms of
compensation are not pre-authorized."); \textit{In re Vaniman Int'l, Inc.}, 24 B.R. 207 (E.D.N.Y.
1982) (previous bankruptcy order denied flat six percent brokerage commission and
required trustee to apply to court for the commission once the sale of property was
completed); Crane Clothing Co. v. Arthur Winer, Inc. (\textit{In re Taxman Clothing Co.}), 134 B.R.
286, 288 (Bankr. N.D. Ill. 1991) ("[Section] 328(a)'s deference does not kick in unless the
appointment order 'expressly and unambiguously state[s] specific terms and conditions (e.g.
specific hourly rates or contingency fee arrangements) that are being approved pursuant
to the first sentence of section 328(a)' . . . .") (citing \textit{In re C & P Auto Transp., Inc.}, 94 B.R.
682, 685 n.4 (Bankr. E.D. Cal. 1988)); \textit{In re Consolidated Bancshares, Inc.}, 49 B.R. 467, 473
(Bankr. N.D. Tex. 1985) (where the contingent fee arrangement had only been agreed to
by the parties, no court approval so no section 328 analysis); \textit{In re B.J. Gaff}, Inc., 37 B.R.
548 (Bankr. D. Minn. 1984) (no prior agreement or court approval under section 328;
additional fees denied where debtor's counsel was retained for two months, did little more
than file the petition and attend the first creditors' meeting, and had already received fees
in the sum of $10,000); \textit{In re Liberal Mkt., Inc.}, 24 B.R. 653 (Bankr. S.D. Ohio 1982) (fee
application was filed by professional persons appointed under section 327; fee award
determined by section 330); \textit{Olympia Holding}, 176 B.R. at 965 ("The reasonableness
standard contained in § 330 generally applies when the Court approves the appointment
of a professional but does not specifically approve the terms of employment.") (citing \textit{In re
Sergio}, 39 B.R. 522 (Bankr. D. Haw. 1984)).
\textsuperscript{53} \textit{C & P Auto Transp.}, 94 B.R. at 682; see also \textit{Zolfo, Cooper & Co.}, 50 F.3d at 261
(3rd Cir. 1995).
\textsuperscript{54} 94 B.R. at 685 n.4.
This conclusion prevents courts from unintentionally being bound to specific terms. There is no reason why the burden should be on the court to specify in its order authorizing retention of the professional that it rejects specific terms and conditions. Instead, the burden rests on the applicant to ensure the court explicitly notes the terms and conditions if the applicant expects them to be established at an early point. Furthermore, the bankruptcy court's duty to conduct an independent examination of fee applications for services rendered, even in the absence of objections, "would be unduly restricted if employment authorization orders were routinely construed as binding the court to particular terms" disclosed in the employment application. If a retention order simply approves employment of a professional as requested in the application with no mention of specific terms, reconsideration should be sought requesting the section 328 approval and, if possible, the specific terms set out in the employment order.

The professional should be aware that some courts have held that evidence of reasonableness of the terms requested should be presented prior to the entry of a retention order pursuant to section 328. A hearing may not be required because the application, and disclosures therein, may be sufficient evidence of the reasonableness of the fee, particularly in light of the fact that judges are deemed fee experts. However, depending on the particular jurisdiction and the exact terms of the employment, an evidentiary hearing may be required to prove the reasonableness of the fee arrangement.

55. Id.
56. In re Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 843 n.8 (3rd Cir. 1994) (collecting cases). See also Landry & Higdon, supra note 36, at 373-75 n.57.
57. Busy Beaver Bldg. Ctrs., 19 F.3d at 843 (court has a duty to review fee application even in the absence of objections by the U.S. Trustee or parties in interest.) See also Landry & Higdon, supra note 36, at 373-76 nn. 56-60 and accompanying text.
58. Zolfo, Cooper & Co., 50 F.3d at 262.
59. Id. (citing In re C & P Auto Transp., Inc., 94 B.R. 682, 685 n.4 (Bankr. E.D. Cal. 1988)).
60. See generally In re Westbrooks, 202 B.R. 520 (Bankr. N.D. Ala. 1996); In re Dividend Dev. Corp., 145 B.R. 651 (Bankr. C.D. Cal. 1992) (section 328(a) clearly anticipates that the court will make a determination as to the reasonableness of a fee arrangement at the beginning of a case).
61. See, e.g., Busy Beaver Bldg. Ctrs., 19 F.3d at 854; Zolfo, Cooper & Co., 50 F.3d at 258; York Int'l Bldg., Inc. v. Chaney, 527 F.2d 1061, 1068 (9th Cir. 1975); In re TMT Trailer Ferry, Inc., 434 F.2d 804, 806 (5th Cir. 1970); Mass Mut. Life Ins. Co. v. Brock, 405 F.2d 429, 432 (5th Cir. 1968); Bergeson v. Dilworth, 875 F. Supp. 733, 739 (D. Kan. 1995).
62. The scope and extent of the evidence required will vary from judge to judge. Once the general requirements for employment are satisfied, i.e., section 327 and Rule 2014, and the nature of the representation is established, the applicant must prove the reasonable-
C. Effect and Benefit of a Section 328(a) Retention Order

With a retention order fixing the terms of employment, the fixed terms are to be applied at the time of the application for compensation. Even so, the professional must still comply with Rule 2016 and file a fee application at the end of the case, or file for interim compensation pursuant to section 331 during the case. The application must meet all the technical requirements of Rule 2016, including stating the services rendered and time expended. This appears to be the case even if the term or condition approved is a contingency fee or some other type of fee arrangement not based on the traditional lodestar approach. In short, Rule 2016 governs the technical requirements of the
application for compensation, and section 330(a) provides the framework for review of all fee applications.\textsuperscript{66} A section 328(a) retention order only provides the standard for review of the compensation, \textit{i.e.}, whatever the fixed terms and conditions were in the retention order, not a reasonableness analysis under section 330(a)(1).\textsuperscript{67}

In the case when no measure for compensation was determined at the outset in the retention order, section 330 envisions a reasonableness determination at the time of the fee application. This usually means an application of the lodestar analysis. However, with preapproval under section 328, the court does not have the power to make a reasonableness review at the end of a case.\textsuperscript{68} By its own terms, section 330(a) is "subject to" the limitations set forth in section 328(a).\textsuperscript{69} Sections 330 and 328(a) work in tandem\textsuperscript{70} and must be read together. Thus, when the court has preapproved the terms and conditions of employment under section 328, section 330(a) provides the "framework for review while section 328 provides the standard for review."\textsuperscript{71} The court cannot "reduce the resulting fee unless the terms of the court's approval 'prove to have been improvident in light of developments not capable of being anticipated' when approved."\textsuperscript{72} For example, "section 330(a)(1) does not supplant section 328(a) and give the judge free reign to void a previously authorized employment agreement for a percentage fee."\textsuperscript{73} Most of the reported decisions that consider this aspect of section 328(a) disallowed

\begin{itemize}
\item \textsuperscript{66} 11 U.S.C. § 105(a) does not authorize judges to abrogate a specific rule.
\item \textsuperscript{67} \textit{In re} Circle K Corp., 191 B.R. 426, 431 (Bankr. D. Ariz. 1996) (The framework for review of § 330(a) is "expressly subject to the limitations of section 328(a).").
\item \textsuperscript{68} \textit{Id.} See, \textit{e.g.}, \textit{In re} Pitrat v. Reimers (\textit{In re} Reimers), 972 F.2d 1127, 1129 (9th Cir. 1992); \textit{In re} Confections by Sandra, Inc., 83 B.R. 729, 731 (B.A.P. 9th Cir. 1987); \textit{In re} Circle K Corp., 165 B.R. 653, 656 (Bankr. D. Ariz. 1994).
\item \textsuperscript{69} \textit{See, e.g.}, \textit{In re} Olympia Holding Corp., 176 B.R. 962, 965 (Bankr. M.D. Fla. 1994); \textit{In re} Circle K Corp., 191 B.R. 426, 431 (Bankr. D. Ariz. 1996); \textit{In re} Cal Farm Supply Co., 110 B.R. 461, 465 (Bankr. E.D. Cal. 1989) ("The compensation provided for in section 330(a) is subject to section 328(a).").
\item \textsuperscript{70} \textit{Circle K}, 191 B.R. at 431.
\item \textsuperscript{71} Unsecured Creditors Comm. v. Webb & Daniel, 204 B.R. 830, 834 (Bankr. M.D. Ga. 1997) (quoting \textit{In re} Westbrooks, 202 B.R. 520, 522 (Bankr. N.D. Ala. 1996)). ("The 'standard of review' created by Section 328 requires a finding of improvidence 'in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions."') (citing § 328(a)); \textit{see also} \textit{Circle K}, 191 B.R. at 431.
\item \textsuperscript{72} \textit{In re} Olympic Marine Servs., Inc., 186 B.R. 651, 654 (Bankr. E.D. Va. 1995). \textit{See also} \textit{Circle K}, 191 B.R. at 431 ("Where a bankruptcy court previously approved compensation terms, it cannot subsequently alter those terms unless the original terms were improvident in light of unanticipated developments.") (citing \textit{In re} Reimers, 972 F.2d at 1128).
\item \textsuperscript{73} \textit{In re} Benassi, 72 B.R. 44, 47 (Bankr. D. Minn. 1987).
\end{itemize}
reduction of previously approved fee arrangements based on the usual tests for "reasonable compensation" under section 330(a). However, some courts erroneously applied a reasonableness standard to reduce a contingent fee arrangement.

This issue was addressed in the case of Pitrat v. Reimers (In re Reimers). The trustee employed an attorney as special counsel for the estate to prosecute a fraud claim. The fee arrangement between the trustee and the attorney provided that the attorney would be awarded compensation of forty percent of the amount recovered for the estate. The bankruptcy court approved the employment and the fee agreement in a retention order.

The attorney succeeded in recovering $37,871.30 for the estate on the fraud claim. Thereafter, the attorney filed an application for compensation seeking authorization for the trustee to pay the attorney $15,101.10 (forty percent of the amount recovered). Rather than apply the approved fee agreement, the bankruptcy court estimated the number of hours the applicant must have worked and multiplied that number by the applicant's hourly rate. There was no finding of unanticipated developments that rendered the original terms of employment approved by the bankruptcy court in the retention order improvident.

The district court affirmed the bankruptcy court. However, the United

74. Id. (citations omitted). See also Reimers, 972 F.2d at 1128-29; In re Confections by Sandra, Inc., 83 B.R. 729, 731 (B.A.P. 9th Cir. 1987); In re Olympia Holding Corp., 176 B.R. 962, 966 (Bankr. M.D. Fla. 1994) (The bankruptcy court "specifically approved the employment agreement and its compensation scheme. There [was] no evidence that unexpected or unforeseen circumstances [had] occurred which cause[d] the approval of the employment agreement to be improvident. Consequently, the Court [could] not conduct a § 330 reasonableness review of the fees requested pursuant to the contract and will grant the application for fees as calculated pursuant to the employment contract terms."); Benassi, 72 B.R. at 47-48; Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955, 960 (9th Cir. 1991).

75. See Begier, Ltd. v. United Jersey Bank, Nos. CIV. A. 93-2085, 88-128425, 1993 WL 315656 (E.D. Pa. Aug. 18, 1993). The authors note that even commentators have erroneously concluded that a reasonableness review under the factors set forth in section 330 is applicable even when a court has pre-approved the fee arrangement. 2 LAWRENCE P. KING, COLLIER ON BANKRUPTCY, ¶ 328.02[1][f], at 328-18 (15th ed. 1996). In fact, the primary authority cited for this proposition by Collier applies a correct analysis of the application of section 328 and rejects the conclusion set forth in Collier. See In re Reimers, 972 F.2d at 1128-29.

76. In re Reimers, 972 F.2d 1127 (9th Cir. 1992).

77. Id. at 1127-28.

78. Id. at 1128.

79. Id.

80. Id.
States Court of Appeals for the Ninth Circuit reversed the lower courts' decisions.\textsuperscript{81}

The Ninth Circuit held the bankruptcy court erred in "assum[ing] that section 330 gave it the power to make a general 'reasonableness' review, despite the express language of section 328."\textsuperscript{82} The Ninth Circuit found the district court erroneously cited to an earlier Ninth Circuit decision, \textit{Yermakov v. Fitzsimmons (In re Yermakov)},\textsuperscript{83} as authority for the bankruptcy court's reduction of the fees requested by the applicant. The Ninth Circuit distinguished \textit{Yermakov} because that case did not involve an arrangement preapproved by the bankruptcy court for payment on a contingency basis.\textsuperscript{84} The case was remanded to the bankruptcy court to award the applicant compensation under the contingent fee agreement, unless the court "conclude[d] the agreement was 'improvident' in light of unforeseeable developments."\textsuperscript{85}

In a very recent case, \textit{In re National Gypsum Co.},\textsuperscript{86} the United States Court of Appeals for the Fifth Circuit faced a similar question. The bankruptcy court entered an order of employment "upon the terms and conditions of that certain engagement letter dated April 16, 1991."\textsuperscript{87} The bankruptcy court also included a statement in the retention order that it reserved the right to consider and approve the reasonableness of the fees on a final basis. At the end of the case, the attorney submitted an application requesting compensation pursuant to the engagement letter in the amount of $2,400,000.\textsuperscript{88} At the fee hearing, the bankruptcy court applied a reasonableness standard and reduced the amount allowed to $2,000,000. The district court affirmed, holding that section 328 was inapplicable because of the extra language in the approval order. This language, according to the district court, allowed the bankruptcy court to use a reasonableness standard and not the improvidence standard set out in section 328.\textsuperscript{89}

The Fifth Circuit ruled that a section 328 retention order could be modified only upon developments "unforeseen when originally approved" and that bankruptcy courts "must protect those [fee] agreements and

\begin{footnotesize}
\textsuperscript{81}. \textit{Id.} at 1129.
\textsuperscript{82}. \textit{Id.}
\textsuperscript{83}. 718 F.2d 1465 (9th Cir. 1983).
\textsuperscript{84}. \textit{Reimers}, 972 F.2d at 1129.
\textsuperscript{85}. \textit{Id.}
\textsuperscript{86}. \textit{In re National Gypsum Co.}, 123 F.3d 861 (5th Cir. 1997).
\textsuperscript{87}. \textit{Id.} at 862.
\textsuperscript{88}. Originally the applicant requested compensation in the amount of $2,825,000 but, upon objection by the debtor, applicant agreed to the reduced amount of $2,400,000. \textit{Id.}
\textsuperscript{89}. \textit{Id.} at 862.
\end{footnotesize}
expectations, once found to have been acceptable." The Fifth Circuit found the additional language included in the retention order did not remove the order from section 328’s provisions, but simply “recited [the court’s] control of the compensation in the event of subsequent and unanticipated circumstances affecting the reasonableness of that agreed fee." The Fifth Circuit reversed and remanded the case with instructions to award fees in compliance with section 328. This case highlights the power of section 328(a)—once terms of engagement are approved, courts cannot apply a reasonableness test after the work is performed and the fee application is filed. The sole statutory basis for modifying the fee arrangement is that it was improvident when made.

D. Safety Valve in Section 328(a)

Section 328(a) provides “a safety valve in the event of unpredictable changes.” The statute expressly permits the court to award fees at variance with the terms of its previous order when they “prove to have been improvident in light of developments unanticipatable” at the time the compensation agreement was approved. The exact meaning of the term “improvident” as used in section 328(a) is not clear because there are very few published opinions analyzing it. However, courts generally have found terms and conditions of employment improvident in two situations, i.e., when “unpredictable facts or circumstances" develop or “unforeseeable and unexpected circumstances intervene." This is consistent with the definition of “improvidently” as set forth in Black’s Law Dictionary, which defines “improvident” as “[a] judgment, decree, rule, injunction, etc., when given or rendered without adequate consideration by the court, or without proper information as to all the

90. Id. at 862-63.
91. Id. at 863.
92. Id.
94. Id. (Note, the court was quoting a prior version of section 328(a) which read in pertinent part “... if such terms and conditions prove to have been improvident in light of developments unanticipatable at the time of the fixing of such terms and conditions.” 11 U.S.C. § 328(a) (1982). The statute now reads “not capable of being anticipated” rather than “unanticipatable.” Id. § 328(a) (1984)); see also In re Olympia Holding Co., 176 B.R. 962, 965 (Bankr. M.D. Fla. 1994) (“This approval [section 328(a)] is subject to provision which allows the Court to award fees which vary from the terms of a previously approved contract, when unpredictable facts or circumstances occur after approval of the agreement upon a finding that the original approval of the agreement terms was improvident.”) (citations omitted).
95. Olympia Holding, 176 B.R. at 965.
96. Benassi, 72 B.R. at 49.
circumstances affecting it, or based upon a mistaken assumption or misleading information or advice.\textsuperscript{97}

It is important to note that simply "unanticipated" developments or circumstances do not warrant a finding of improvidence. Section 328 "allows revision of a fee agreement only if a development was not capable of being anticipated at the time of the fixing of such terms and conditions."\textsuperscript{98} Whether the event was actually anticipated is immaterial. The relevant inquiry is whether the event was capable of anticipation.\textsuperscript{99} Therefore, a simple finding that the professional seeking compensation did not anticipate a change in circumstances does not satisfy section 328(a).\textsuperscript{100} To alter a fee agreement under section 328, the bankruptcy court must find that it was not possible for the professional seeking compensation to anticipate the change in circumstances.\textsuperscript{101}

At least one commentator, Professor Cynthia Baker, criticized the bankruptcy court's power under section 328(a) to modify a fixed-fee arrangement with the advantage of hindsight.\textsuperscript{102} Professor Baker's criticism has validity only if the power to modify a fixed-fee arrangement is broad and modifications are made merely on hindsight.

However, the power to modify a fixed-fee arrangement is very limited and applies only when the express conditions in section 328(a) are satisfied.\textsuperscript{103} Twenty-twenty vision at the end of the case will not permit the bankruptcy court to modify the fixed fee.\textsuperscript{104} Professor Baker also suggests that the power of the court to modify a fixed fee under section 328(a) limits the power of debtors or committees to retain professionals except on an hourly basis.\textsuperscript{105} Professor Baker states:

\begin{enumerate}
\item[99.] \textit{Id.} This conclusion is supported by the modifications made to the statute by Congress. A prior version of section 328(a) read in pertinent part "... if such terms and conditions prove to have been improvident in light of developments unanticipatable at the time of the fixing of such terms and conditions." 11 U.S.C. § 328(a) (1982). The statute now reads "not capable of being anticipated" rather than "unanticipatable." \textit{Id.} § 328(a) (1994). A plain reading of the statute, as amended, dictates the conclusion that "unanticipatable" developments are insufficient to deviate from preapproved terms and conditions.
\item[100.] \textit{Id.}
\item[101.] \textit{Id. See also In re Warrior Drilling & Eng'g Co.,} 9 B.R. 841, 847 (Bankr. N.D. Ala. 1981); Seiler v. First Nat'l Bank of Babbit (\textit{In re Benassi}), 72 B.R. 44 (D. Minn. 1987).
\item[103.] \textit{Warrior Drilling} & \textit{Eng'g Co.}, 9 B.R. at 847.
\item[104.] \textit{Benassi}, 72 B.R. at 49.
\item[105.] Baker, \textit{supra} note 102, at 55.
\end{enumerate}
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 suggest 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. Section 328(a) authorizes the bankruptcy court to take that risk premium away after the fact, and would seem to impair DIPs' and committees' ability to use alternative fee arrangements to control costs.\textsuperscript{106}

Professor Baker's general analysis of the risks with certain fee arrangements applies both in and outside of bankruptcy, but the conclusion that section 328(a) authorizes courts to take the risk premium away after the fact is a misreading of the statute.

Section 328(a) only takes the risk premium away when the standard for modification of fixed-fee arrangements in this section is interpreted broadly and expanded beyond the very limited improvidence standard. The risks associated with fixing the fee at the outset of representation do not change simply because of bankruptcy and the power of section 328(a) to modify fee arrangements. When section 328(a) is properly applied, professionals in bankruptcy cases bear the same risks at the outset of the representation as in nonbankruptcy contexts, and bankruptcy professionals are in the same position as nonbankruptcy professionals. This helps promote the Code's clear intent of having professionals inside and outside of bankruptcy be compensated comparably and bear similar risks.\textsuperscript{107}

E. Expenses and Section 328(a)

It is important to note that expenses are not dealt with under section 328(a). By its own express language, section 328 is a "[l]imitation on compensation of professional persons." Thus, section 328(a) involves only limitations on fees or compensation, not expenses.\textsuperscript{108} Reimbursement of expenses are governed by the standards set forth in section 330(a)(1)(B) which provide "reimbursement for actual, necessary expenses."\textsuperscript{109}

\textsuperscript{106} Id. at 55-56.

\textsuperscript{107} Benassi, 72 B.R. at 47.


Section 330(a)(1)(B) provides little guidance in determining whether a particular expense was “necessary,” and thus reimbursable. This is particularly true because there are innumerable potential expenses that may be reimbursable. Generally, the issue is whether the particular expense “was incurred because it was required to accomplish the proper representation of the client.” If the answer is yes, then the expense is generally “necessary” under section 330(a)(1)(B), and thus reimbursable. Just as with compensation requests, the applicant has the burden of establishing that the expense was necessary, courts will not presume it to be so.

IV. USE OF SECTION 328 AND ALTERNATIVE BILLING METHODS

The Third Circuit recognizes that the lodestar approach may not always be the prevailing billing method, and other billing practices in bankruptcy are emerging. The Third Circuit stated that section 330 “by no means ossifies the lodestar approach as the point of departure in fee determinations.” With the rise of competitive pressures and the ceaseless evolution of the legal community, we may expect to witness law practitioners adapt to the changed circumstances by developing alternative billing practices and methods.” The Eleventh Circuit likewise recognized that the legislative history to section 330(a) indicates a clear “desire to promote the same billing practices in bankruptcy cases as in other branches of legal practice.”

It is with this flexibility of section 330, and the market approach embraced therein, that section 328(a) permits professionals to have alternative fee arrangements addressed and possibly approved at the outset of the case. In fact, one court wrote that “the flexibility written into this standard [§ 328(a)] encourages bankruptcy judges to approve

110. Cal Farm Supply Co., 110 B.R. at 465 (citing proposition that reimbursable expenses include, but certainly are not limited to, meals, word processing, messenger service, taxi fare, parking, photocopying, postage, express mail services, legal research computer costs, faxing, and mileage for out-of-town travel).
112. Id.
114. 103 B.R. at 939.
115. In re Busy Beaver, 19 F.3d 833, 856 (3rd Cir. 1994).
116. Id. (citing Robert E. Litan & Steven C. Salop, Reforming the Lawyer-Client Relationship Through Alternative Billing Methods, 77 JUDICATURE 191 (Jan.-Feb. 1994)); Steven Brill, Replacing the Hourly Rate, AM. LAW. at 6 (Sept. 1992); Deborah Graham, Billing Methods: Firms Begin to Tinker, LEGAL TIMES, May 20, 1985, at 1.
117. Stroock & Stroock & Lavan v. Hillsborough Holdings Corp. (In re Hillsborough Holdings Corp.), 127 F.3d 1398, 1403 (11th Cir. 1997).
compensation arrangements that reflect market conditions and to fashion arrangements suitable to the circumstances of the case before it.\textsuperscript{118} Granted, innovative billing strategies should not be tested through the compensation provisions of the Code. However, once alternative practices are comfortably established in the realm of comparable nonbankruptcy legal services, the Code provides the mechanism for bankruptcy courts to consider such billing practices.\textsuperscript{119}

The number of different fee arrangements is limited only by the imagination. Of course, the standard time-based billing, flat fees, and contingent fees are the most common arrangements. However, professionals should be cognizant that these type of fee arrangements are not the only thing that section 328 can be used to establish. Time of payment, frequency of payments, amount of each payment, frequency of applications, and hourly rates of professionals are only a few of the variables section 328 can establish at the beginning of representation.

Professionals, and particularly attorneys, are being creative in combining the different types of fee arrangements, creating a form of hybrid fee arrangements for the unique circumstances of the case at bar. Over the past several years and with increasing frequency, the bankruptcy courts have addressed the application of some nonlodestar fee arrangements in bankruptcy. The following are examples of alternative billing arrangements which have been addressed by the courts in recent years.\textsuperscript{120}

A. Periodic PostPetition Retainer Payments—"Knudsen retainers"

1. Mega Cases. Probably the leading case on innovative billing methods in bankruptcy cases was \textit{In re Knudsen}.\textsuperscript{121} In \textit{Knudsen} the United States trustee appealed an order authorizing a fee payment procedure where professionals and the creditors' committee were to be paid each month without prior court approval of billing statements. Every three months, counsel intended to serve and file an application for approval of the statements. The statements were to be paid promptly by the debtor if found acceptable. If quarterly statements were not timely filed, the debtor would not be required to pay counsel until the statements were approved by the court.\textsuperscript{122}

\begin{enumerate}
  \item \textit{In re Niover Bagels, Inc.}, 214 B.R. 291, 294 (Bankr. E.D.N.Y. 1997).
  \item 11 U.S.C. § 328(a) (1994).
  \item See generally Litan & Salop, supra note 116, at 197.
  \item United States Trustee v. Knudsen Corp. (\textit{In re Knudsen Corp.}), 84 B.R. 668 (B.A.P. 9th Cir. 1988).
  \item \textit{Id.} at 669-70.
\end{enumerate}
The U.S. Bankruptcy Appellate Panel for the Ninth Circuit, ("BAP") acknowledging that the issue presented was one of first impression, was compelled to "reconcile section 328's broad language which includes the term 'retainer' with section 331's specific requirements including notice and hearing." The BAP read section 328(a)'s inclusion of the term "retainer" as indicating that "in certain rare circumstances where adequate safeguards are taken, a bankruptcy court may implement a fee payment procedure such as the one used here." The United States trustee asserted, and the BAP agreed, that allowance and disbursement of fees is permitted only in accordance with sections 330 and 331. However, the BAP did not find that those sections "prohibit the transfer of funds to professionals prior to compliance with those sections."

"Section 328(a) specifically states that a bankruptcy court may authorize a retainer as part of a compensation agreement. A retainer contemplates payment of a lump sum at the beginning of a case or periodically thereafter."

The BAP held that three critical factors must exist: (1) the fees must not be finally allowed until an "application is filed; (2) an opportunity for objection has been provided; and (3) the court has reviewed the application." In affirming the trial court's decision, the BAP identified four specific factual criteria: (1) the case is unusually large; (2) an extended waiting period for payment would place an undue hardship on counsel; (3) counsel can respond to any reassessment; and (4) the fee retainer procedure is subject to a noticed hearing prior to any payment.

Although the standards in Knudsen have been adopted by many courts, the case has not received universal support. For instance, in In re Genline the bankruptcy court cited the plain language of section 331 in rejecting a Knudsen type fee arrangement. The court stated that section 331 only allows interim disbursements to profession-
 Although "[a]fter notice and a hearing." Consequently, the court concluded that the debtor’s proposed payments to professionals on a monthly basis without prior notice to creditors and court approval were impermissible under the Code. The court criticized the Knudsen court’s finding that the language of section 328, which provides for the employment of professionals “on any reasonable terms and conditions of employment,” permits a court to ignore the unambiguous language of section 331 which requires “notice and a hearing preceding disbursements to professionals.” The court found that disbursements to the professionals were subject to section 331’s requirements of notice and a hearing prior to such disbursement.

2. Small Cases. Most of the opinions authorizing a Knudsen retainer rely upon a “mega-case exception” and reject the arrangement in middle market cases. In fact, one of the specific criteria articulated in Knudsen was that the case be unusually large. However, the Code does not mandate that periodic retainer payments are available only in mega cases.

In the case of In re Niover Bagels, Inc., a middle-market case, the bankruptcy court was confronted with a request to approve the employment of an accounting firm under a compensation arrangement in which the “accountant would be paid his invoices on a monthly basis in amount of $600 at an hourly rate of $175, not to exceed $7,200.” The court declined to limit the use of the Knudsen type of fee arrangement to the mega-case. The court rejected the line of cases limiting the Knudsen retainer to mega-cases on the rationale that those cases’ holdings undermined the tight reporting requirements of the United States trustee and the court.

133. Id.
134. Id.
135. Id. (citing Knudsen, 84 B.R. 668 (finding that section 331 must be construed in light of the language contained in section 328 which authorizes the employment of professionals “on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis.”) (11 U.S.C. § 328(a) (1994)).
137. Knudsen, 84 B.R. at 672.
139. Id. at 291.
140. Id.
141. Id. at 295.
142. Id. at 294 (refusing to follow In re Shelley’s, Inc., 91 B.R. 803 (Bankr. S.D. Ohio 1988); In re ICS Cybernetics, Inc., 97 B.R. 736 (Bankr. N.D.N.Y. 1989); In re Pacific Forest Indus., 95 B.R. 740 (Bankr. C.D. Cal. 1989)).
The court reasoned that accountants' fee applications for standard services are not usually objected to. Furthermore, "[t]here is nothing especially esoteric about reviewing monthly management compilations, assisting management in preparing these compilations, assisting and reviewing cash flow projections, monthly audits or in preparing state and federal tax returns." Those services can be performed for a flat monthly management compilations fee. The court criticized the United States trustee for requiring detailed monthly operating reports from the debtor. At the same time, through its objection to the fee arrangement, the court created a barrier to employing cost-efficient accountants for debtors choosing to prepare the required operating reports.

This case provides a very expansive interpretation of Knudsen. It opens up Knudsen fee arrangements to Chapter 11 cases of any size and, in effect, ignores the criteria set forth by the BAP in Knudsen. This case carefully considers the challenge courts face to develop cost-efficient case administration strategies for small business cases and, in so doing, provides a broad interpretation of the possible fee arrangements that may be used in bankruptcy cases of any size.

B. Draw Down Prepetition Retainer Without Prior Approval

In response to the holding in Knudsen and based upon dialogue with both the Bench and the Bar, the United States trustee for the Central District of California established the U.S. Trustee Guide to Applications for Employment of Professionals and Treatment of Retainers of the Central District of California ("Guide"). The Guide provides a broad interpretation of the Knudsen holding, at least as related to prepetition retainers. In short, the Guide "allow[s] for the dissipation of prepetition retainers without prior order of the court and without distinction as to the size of the case."

The Guide provides a procedural mechanism for professionals to draw down retainer. The professional must submit a fee statement, in the form of a fee application, to the United States trustee on a monthly basis
and serve it on the appropriate parties. The professional can withdraw the amount reflected in the fee statement without an order, pending the filing of the interim fee application after 120 days has passed, if no party objects to the fee statement. If there is an objection, a hearing will be held. The Guide explicitly states that this procedure does not alleviate the professionals’ requirement to file interim fee applications every 120 days. When the retainer is drawn down, the fee statement procedure cannot be used.

Just as in Niover, the size of the case should not be the determinative factor in condoning or approving a particular fee arrangement. This reflects the need to treat bankruptcy professionals like nonbankruptcy professionals and limit artificial barriers to timely receipt of compensation, while still adhering to the stringent Code requirements for approval of compensation.

C. Draw Down Prepition Retainer and Replenish Retainer Without Prior Approval

A variation of the Knudsen approach, and the procedure established by the United States Trustee in the Central District of California, was approved by the bankruptcy court in In re Lotus Properties LP. The attorney for the debtor was paid a prepetition retainer of $7,500 with the agreement that fees and costs incurred postpetition would be paid on an ongoing basis. The debtor’s attorney sought to have this agreement approved by the bankruptcy court so the attorney could withdraw funds from the pre- and postpetition retainer without filing a fee application.

The United States trustee objected to counsel making draw downs during the first four months of the case for any sum in excess of the initial retainer primarily because the case was not a mega case and, therefore, failed to meet the Knudsen criteria. Furthermore, the trustee alleged that prior to a draw down, professionals must have a court order.

151. Id. at 396. (The fee statement must be served upon the official creditors’ committee or, if no committee is appointed, on the twenty largest unsecured creditors, on those parties who have requested special notice, and upon the United States trustee).
152. Id.
153. Id.
154. Id.
155. Id. at 398.
156. Id.
157. Id.
158. Id. at 397-98.
The bankruptcy court found the exercise of a draw down procedure, coupled with a fixed retainer ceiling, was consistent with the intent of Knudsen and the United States Trustee Guidelines. The bankruptcy court allowed the draw down procedure during the first four months after the petition and set a minimum retainer of $25,000, a sum the court found "would have been reasonably requested by counsel to initially represent the debtor."[159]

However, the debtor was unable to fund such a retainer. Therefore, the bankruptcy court reasoned that it was permissible to replenish this retainer account. The replenished amount was "to be treated as a prepetition retainer, although received in postpetition increments."[160] Any unused retainer amount after the four-month period would remain in a trust account until the filing of the first fee application.[161] However, if fees and expenses greatly exceeded the retainer amount during the retainer period a fee application could be filed.[162]

D. Hourly Compensation and Use of PrePetition Retainer

In the case of In re W & W Protection Agency, Inc.,[163] the bankruptcy court approved a hybrid type of fee arrangement.[164] The debtor's attorney sought approval to be compensated on an hourly basis while, at the same time, holding on to a so-called "evergreen" prepetition retainer for payment upon counsel's final fee application. The United States trustee objected and argued for a restrictive interpretation of section 328(a). In the United States trustee's view, section 328(a) only allowed courts to approve one of the enumerated examples of compensation therein. Even if the arrangement were approved, a draw down of the prepetition retainer could be made only after a hearing and approval of the court.[165]

The bankruptcy court considered "[s]ection 102(3) of the Bankruptcy Code provides that the word 'including' is not limiting and § 102(5) which provides that the word 'or' is not exclusive."[166] As such, the court concluded that "under section 328(a), compensation on one of the bases listed, or any combination of those bases is permissible so long as

[159. Id. at 398.]
[160. Id.]
[161. Id.]
[162. Id.]
[163. Id.]
[164. Id.]
[166. Id. at 623.]
[167. Id. at 622.]
[168. Id.]
the terms and conditions are ultimately determined to be 'reasonable.'\textsuperscript{169} The court authorized the debtor's attorney to hold the prepetition retainer in escrow towards payment against its final fee application, or until such time as the court determined otherwise.\textsuperscript{170}

**E. Flat Fee In Small Chapter 11 Cases**

Flat fees are customary in Chapter 13 cases\textsuperscript{171} and are not uncommon in cases under Chapter 12. Flat fees work in Chapter 13 cases because most are routine, and the services required are predictable.\textsuperscript{172} Courts approve thousands of Chapter 13 fee requests each year and can easily gauge the value of an attorney's services in most cases.

In an apparent case of first impression, \textit{In re Pineloch Enterprises, Inc.},\textsuperscript{173} the court confronted the issue of extending flat fees from Chapter 12 and 13 cases to a small business Chapter 11 case. The bankruptcy court concluded that "[S]mall [B]usiness chapter 11 cases generally are more complicated than those in Chapter 13, but not to the degree that would inhibit the use of flat fees."\textsuperscript{174} The bankruptcy court approved a flat fee of $5,000 at the outset of the case; however, the fee had to "be held in the attorney's trust account until it [was] approved by the court and . . . earned by counsel."\textsuperscript{175}

The court set an admittedly arbitrary schedule of when the fee was earned. The court allowed:

\begin{itemize}
  \item \textsuperscript{169} \textit{Id.} at 623.
  \item \textsuperscript{170} \textit{Id.}
  \item \textsuperscript{171} \textit{See supra} notes 5 and 64.
  \item \textsuperscript{172} \textit{See supra} notes 5 and 64.
  \item \textsuperscript{173} \textit{In re Pineloch Enters., Inc.}, 192 B.R. 675 (Bankr. E.D.N.C. 1996).
  \item \textsuperscript{174} \textit{Id.} at 678.
  \item \textsuperscript{175} \textit{Id.} at 679 (aligning with the majority rule "that all retainers, whether general retainers, flat fee retainers, advance fee nonrefundable retainers, or advance fee security retainers, must be held in trust pending court approval.") (citing \textit{In re NBI, Inc.}, 129 B.R. 212 (Bankr. D. Colo. 1991) (prepetition "earned" retainers are unreasonable in bankruptcy as they nullify Code protections, therefore such retainers remain property of the estate required to be held in trust by counsel and may be drawn against only with court approval); \textit{In re Chapel Gate Apartments, Ltd.}, 64 B.R. 569, 575 (Bankr. N.D. Tex. 1986) (terms of retainer are determined by statute and court's discretion regardless of agreement of counsel and client); \textit{In re Hathaway Ranch Partnership}, 116 B.R. 208 (Bankr. C.D. Cal. 1990) ($50,000 "earned in full" retainer was advance fee retainer and had to be kept in trust); \textit{In re Independent Sales Corp.}, 73 B.R. 772, 774-75 (Bankr. S.D. Iowa 1987) (prepetition general retainers must be held in trust to extent they are for services during pendency of case); \textit{In re Doors and More, Inc.}, 127 B.R. 1001 (Bankr. E.D. Mich. 1991) (where $4,000 retainer was not held in trust, all fees were denied); \textit{but cf. In re McDonald Bros. Constr., Inc.}, 114 B.R. 989 (Bankr. N.D. Ill. 1990).\end{itemize}
one third of the flat fee to be earned when counsel attends the meeting of creditors, one third when the plan and disclosure statement are filed and the disclosure statement conditionally approved, and one third when the plan is confirmed. If the plan is not confirmed, counsel may apply for the balance any time after the confirmation hearing.\(^{176}\)

The court found there was "no reason why [it] cannot establish the amount of the flat fee at the beginning of the case after notice has been given to all creditors pursuant to § 330(a)(1) and [Rules] 2002(a)(7), 2002(c)(2), and 2016(a)."\(^{177}\) In fact, several practical reasons supported the approval of flat fees in Chapter 11 cases. For example, administrative costs can be predicted accurately with flat fees, and this predictability acts as an inducement for the debtor's attorney to quickly facilitate a case to reorganization.\(^{178}\)

The bankruptcy court also recognized that the flat fee provides two important advantages to attorneys.\(^{179}\) The flat fee eliminates the delay in compensation a professional must incur. Under the flat fee arrangement, the professional does not have to file detailed time records.\(^{180}\) Furthermore, if the flat fee is later determined to be "improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions," the fee can be adjusted under section 328(a).\(^{181}\)

F. Flat Fee In Mega-Chapter 11 Cases

In a unique experiment departing from the usual hourly rate billing procedure used in large cases, Judge Robert J. Newsome, in In re Home Express, Inc.,\(^{182}\) recently offered an alternative means of arriving at a reasonable fee in large cases, specifically, a flat fee. In Home Express, shortly after appointment of counsel for the debtor, counsel indicated "that the key professionals intended to file an application to establish interim compensation procedures consistent with In re Knudsen."\(^{183}\) In response, Judge Newsome advised the parties that, in his view, the fee process under section 330 in mega cases was "too burdensome for the

\(^{176}\) Pineloch Enters., 192 B.R. at 678.

\(^{177}\) Id.

\(^{178}\) Id.

\(^{179}\) Id.

\(^{180}\) Id. The elimination of filing fee applications as required by Rule 2016 is suspect. See supra note 54.


\(^{182}\) In re Home Express Inc., 213 B.R. 162 (Bankr. N.D. Cal. 1997).

\(^{183}\) Id. (citing In re Knudsen, 84 B.R. 668 (B.A.P. 9th Cir. 1988)).
court to administer without assistance and somewhat questionable in its efficacy." 184

Judge Newsome proposed “that the professionals either could agree to a flat rate for all of their services in this case or, pursuant to Federal Rule of Evidence 706, [he] would appoint [an] expert to review the time sheets and otherwise assist the [court] in the fee-setting process.” 185 Under the flat fee arrangement, the professionals were required to submit an analysis of the time necessary for the services to be rendered, a comparison of fees approved in similar cases, and the aggregate amount of fees to be sought in the case. 186

The professionals voiced concerns about matters they could not reasonably anticipate to arise and opponents who might try to take advantage of the limitations on their fees. However, Judge Newsome responded that “most Chapter 11 cases are filled with surprises, both good and bad, and that they should build such contingencies into their flat fee.” 187 Furthermore, the court noted, section 328(a) allows modification of the approved fee if a remarkable event arises in the case. 188

The professionals chose the flat fee option and thereafter proposed a flat fee based on less than the entire case. Judge Newsome held a flat fee based on less than the entire case was unsatisfactory because professionals may obtain a windfall by delaying claims objections and other matters post-confirmation. 189 The professionals then made projections based on the case lasting twelve months and included all work necessary to fully administer the Chapter 11. 190

The court adjusted some of the numbers downward. For instance, the court found that two hundred hours reserved for work on employment applications was excessive. The time allotted for preparation of fee applications was all but eliminated because the only application contemplated would be for a final fee order at the end of the case, which allowed the amounts already paid. The proposed blended hourly rates were also reduced based upon the court’s observations of what other professionals in the area charged in comparable cases. 191 Thereafter,

184. 213 B.R. at 165.
185. Id.
186. Id.
187. Id.
188. Id.
189. Id.
190. Id. at 166.
191. Id.
the court set proposed flat fees and provided for the draw of such fees on a monthly basis. The proposed flat fees “did not include expenses, which were to be monitored by the debtor’s accounting staff pursuant to the court’s published fee and expense guidelines.”

After arriving at the proposed flat fees, the court directed the debtor and the creditor’s committee chairperson to submit a sworn statement of position regarding the proposed flat fee and all parties in interest be provided notice and an opportunity to object to the flat fee. Additionally, on the United States trustee’s request, the court directed the professionals to provide the United States trustee with an invoice and time sheets for the fees received each month. The court then entered an order approving the flat fee arrangement under section 328(a).

Interestingly, after the careful projections and several hearings at the outset of the case, the professionals requested additional fees later in the case based on certain circumstances the professionals argued were unanticipatable at the time of the court’s approval of the flat fee. The court considered the merits of the request for modification of the flat fees under the standard set forth in section 328(a) and granted a modification in part.

This case is an excellent example of the correct use of section 328(a). Judge Newsome carefully considered the proposed flat fees at the beginning of the case and made a reasonableness determination at that time. All parties were given an opportunity to be heard on the proposed flat fee. Thereafter, Judge Newsome approved the flat fee under section 328(a). Later in the case, upon appropriate motion, Judge Newsome correctly applied the standard set forth in section 328(a) for modification of a preapproved fee arrangement under section 328(a).

192. See id. The court set the following flat fees for the entire case: Wright, Robinson/Kaufman & Logan — $860,000; Bronson, Bronson & McKinnon — $564,375; Gray, Cary, Ware & Freidenrich — $215,000; BDO Seidman — $300,000; Deloitte & Touche — $150,000).

193. Each of the firms were to receive a draw on these flat fees in the following amounts: Wright, Robinson/Kaufman & Logan — $75,000 per month; Bronson, Bronson & McKinnon — $45,000 per month; Gray, Cary, Ware & Freidenrich — $20,000 per month; BDO Seidman — $30,000 per month; Deloitte & Touche — $20,000 per month. See id.

194. Id.
195. Id.
196. Id.
197. Id.
198. Id.
199. Id. at 167.
200. See id.
Beyond the excellent technical application of section 328(a) in the *Home Express* case, Judge Newsome recognized the tremendous benefit of experimenting with nonlodestar fee arrangements. In a case the size of *Home Express*, with professional fees into the millions of dollars, the resources of the court and ultimately the estate, through appointment of an expert to review the time records, would have been unduly drained to comply with the traditional lodestar fee process. Although considerable time and several hearings were required to set the flat fees, certainly it was much more efficient than a review of the voluminous fee applications which would have been filed in the case.

V. CONCLUSION

It is apparent that nothing is certain in the fee compensation area. While the lodestar method for fee arrangement is useful because, on its face, it is easily applied, it carries several inherent problems such as unpredictability and undesirability. Recognizing the problems associated with lodestar fee arrangements and the need to have bankruptcy professionals compensated similarly to those professionals outside of bankruptcy, Congress enacted section 328. Section 328 provides a useful mechanism by which professionals can be reasonably certain that their fee contracts will be supported by the court and approved at the fee application process. To obtain the benefit of section 328, however, requires prior approval of the terms of the fee contract, which in turn usually requires some type of reasonableness test. Without prior approval, courts must use a reasonableness standard under section 330, leaving counsel with only a general idea of whether their fee will be approved. Section 328 provides professionals with greater assurance that the preapproved terms will be enforced, and that only in an improvident situation will those terms be disturbed. Professionals employed under section 328 should beware of courts using the reasonableness standard instead of the improvidence standard. Because courts have inherently imposed a reasonableness standard since the beginning of the fee application process, it is, and will be, difficult for courts to utilize a standard other than reasonableness. Professionals are encouraged to receive an employment order under section 328 that is as specific as possible. This will leave courts little room to maneuver when the fee application is eventually filed.