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Baker & Botts – – Is The Second Shoe About To Drop?

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When the Supreme Court issued its decision in *Baker & Botts L.L.P. v. ASARCO LLC* in June, it caused something of a flutter in the bankruptcy community. The decision held that a professional could not recover for the fees it incurred in defending against objections to its fee application. The decision focused on the so-called "American Rule" as "the basic point of reference." Under the American Rule, a party is responsible for its own legal expenses unless a statute or contract provides otherwise. The Court went on to conclude that section 330 of the Bankruptcy Code did not provide a basis for a departure from the American Rule. The Court noted that compensation authorized by that section is limited to "actual, necessary services rendered," which suggests the services must be for the benefit of the client rather than the professional.

In an earlier post, we suggested that the literal application of the Baker & Botts decision may be more limited than some had feared. However, the indirect impact may be more troubling. Two recent developments suggest that we have not seen the last of the issues regarding fees or expenses for defense of professionals.

One expectable response to the Baker & Botts decision was for professionals to include express language about reimbursement in their engagement documents. In two recent Delaware cases, that effort has been challenged by the United States Trustee. It seems difficult to imagine that one could, merely by contract draftsmanship, create an exception to the American Rule when one did not otherwise exist in the statute. And the Supreme Court's focus on "services rendered" further complicates any effort to draft eligibility for what must be viewed as essentially a self-protective effort to defend one's own compensation.

Another recent decision points out the fact that defense of fee application objections are not the only instances in which a professional might incur legal expenses. *In re Walker Land & Cattle, LLC* involved an accountant who was engaged to provide an audit of the debtor's operations. The engagement agreement approved by the bankruptcy court expressly provided that the debtor would reimburse the accountant for any legal expense costs incurred.

Following the completion of the audit, a creditor noticed the accountant for deposition. The accountant sought representation from the debtor's counsel, who advised that he could not provide representation in view of the potential conflict. The accountant then hired counsel for representation in connection with the deposition and a related court appearance in support of the work done on the audit.

Subsequently, when the accountant filed a fee application requesting reimbursement for the legal costs as an expense of the engagement, the United States Trustee objected. The debtor joined in the objection on the theory that the deposing creditor should bear the cost of the fees rather than the estate. While the issue dealt with out of pocket expenses rather than services, as with Baker & Botts it did turn on whether the expenses incurred were “reasonable and necessary.” The bankruptcy court held that the expenses should be evaluated in terms of their support for the services provided by the professional to the estate. Finding that the attorney did not aid in the performance of the audit, the court denied recovery for the legal expenses incurred.

One might reasonably complain that when a professional is forced to incur legal expenses in defense of the services it rendered for the estate, that such costs should be viewed as “reasonable and necessary.” In *Walker Land & Cattle*, the debtor benefited from the audit performed and from the accountant’s defense of that audit in the deposition and the hearing. That nexus of benefit between the services and the estate seems much stronger than the Baker & Botts example where the professional itself was the ultimate beneficiary of the expenses being incurred.

Advisers in bankruptcy cases have regularly negotiated indemnification and cost reimbursement provisions that would cover, among other things, legal expenses incurred by the advisor in discovery activities as well as the cost of defending claims brought directly against the advisor. The Bankruptcy Code language that expenses must “reasonable and necessary” closely tracks the language for eligibility of legal fees. It may be difficult to argue that the Baker & Botts rationale should not be applied to expenses as well as fees. And if the Baker & Botts rationale is extended to expense reimbursement, it may have a broader impact on the world of bankruptcy professionals than initially imagined.

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