The Chapter 11 Financial Advisors

Stephen J. Lubben*

It has been observed that large chapter 11 cases have become increasingly "professionalized."[1] In particular, while once debtor's counsel might have handled the bulk of the reorganization, the debtor now routinely retains specialized professionals to address specific aspects of the case.[2]

Among the most controversial of these non-legal professionals have been the financial advisors, as they often earn transaction fees based on either the sale or reorganization of the debtor.[3] Specifically, financial advisors are typically compensated with a combination of flat monthly fees and outcome contingent transactional fees, and thus fit uneasily into the chapter 11 system, which is largely dominated by lawyers, and former lawyers acting as judges, both of whom are most accustomed to billing hourly rates plus expenses.[4] And then, of course, the most

---

* Daniel J. Moore Professor of Law, Seton Hall University School of Law. This paper is based on my dissertation prepared for the Ph.D. program at the University of Groningen, Department of Law and Economics, which is in turn based in part on data gathered by the author as part of the ABI Chapter 11 Professional Fee Study, which was funded by a grant from the American Bankruptcy Institute, the ABI Endowment Fund, and the National Conference of Bankruptcy Judges. I am grateful for the ABI and NCBJ's assistance with this project. All conclusions are my own and do not necessarily reflect the views of the ABI or the NCBJ or their members.

[1] Jo Ann Brighton et al., *For Better Or Worse: Chapter 11 In The Post-BAPCPA Downturn*, 7 DEPAUL BUS. & COM. L.J. 555, 578 (2009).

[2] For an empirical study of the cost of bankruptcy counsel, see my companion working paper *The Chapter 11 Attorneys*.

[3] http://www.bloomberg.com/apps/news?pid=20601087&sid=apzbxu6eOxik. *See* In re Hillsborough Holdings Corp., 125 B.R. 837 (Bankr. M.D. Fla. 1991).

[4] Michael L. Cook & Stephen J. Lubben, *Retention, Payment, Ethical And Other Obstacles For Non-Legal Professionals In Chapter 11 Reorganizations*, 66 PLI/NY 175 (1999) ("Courts throughout the country differ in their views of non-legal

Electronic copy available at: http://ssrn.com/abstract=1937880

vocal commentators on financial fees are also lawyers, in the form of law professors.[5]

It may be that attorneys are poor observers of other professionals' fee structures and general business practices. But given the increasing importance of financial advisors in chapter 11, and other reorganization schemes, the need for some evidence of how these advisors influence chapter 11 costs is increasing as well.

This short paper begins the discussion by considering a sample of financial advisors in chapter 11 cases filed in 2004. Part I of the paper describes the dataset and the types of financial advisors that routinely appear in chapter 11 cases. Part II provides some basic descriptive statistics regarding these financial advisors, and also provides a brief discussion of the types of professionals that routinely appear in chapter 11 cases, beyond bankruptcy counsel. Among other things, this part shows that financial advisors, although receiving much attention and criticism, actually cost slightly less, on average, than the debtor's bankruptcy attorneys.

Part III then models the costs of financial advisors. In this part of the paper I find that cost increases if both the debtor and the committee retain financial advisors. Costs also increase with the contentiousness of the case, which I suggest reflects a tendency to focus on the large, lump-sum fees earned by financial advisors in such cases.

---

professionals. Retention arrangements that are routinely approved in Manhattan and Wilmington may be met with skepticism, if not outright hostility, in Los Angeles, Denver, or Tampa.").

[5] LYNN M. LOPUCKI & JOSEPH W. DOHERTY, PROFESSIONAL FEES IN CORPORATE BANKRUPTCIES: DATA, ANALYSIS, AND EVALUATION 117 (2011).

Electronic copy available at: http://ssrn.com/abstract=1937880

Part IV of the paper then turns to look at the specific issue of debtor-retained financial advisors, as they make up the bulk of financial advisor cost in chapter 11. Here the most interesting finding is that debtor size matters, where it does not seem to matter when financial advisors are considered in the aggregate. This again suggests the importance of a finer understanding of the workings of financial advisors, and what they actually "do."

Part V of the paper wraps up by considering the legal and policy implications of these findings. In particular, I note how little the Bankruptcy Code as drafted in 1978 is suited to the types of compensation structures that financial advisors and turnaround consultants normally receive. Looking at the specific issue of section 328(a), I argue that it may be time to revamp large parts of the Code to reflect the reality of modern chapter 11 practice.

I. The Dataset

I begin with the dataset I collected for the American Bankruptcy Institute's Chapter 11 Fee Study.[6] This dataset includes cases that were originally filed in 2004, and the data within each dataset comes from publicly available court filings that were primarily collected from PACER.[7]

The dataset is non-random, comprising all 2004 bankruptcy cases listed in the "Major Bankruptcies" database on www.bankruptcydata.com (published by New

[6] The ABI Chapter 11 Fee Study is available online (http://ssrn.com/abstract=1020477) and is extensively discussed in Stephen J. Lubben, *Corporate Reorganization & Professional Fees*, 82 AM. BANKR. L.J. 77 (2008) (hereinafter, "Lubben (2008)").
[7] http://pacer.psc.uscourts.gov/. *See generally*, Jay Lawrence Westbrook, *Empirical Research in Consumer Bankruptcy*, 80 TEX. L. REV. 2123, 2148 (2002).

Electronic copy available at: http://ssrn.com/abstract=1937880

Generation Research, Inc.) except for cases initially filed under chapter 7 and not converted to chapter 11 and cases filed under former section 304 of the Bankruptcy Code.[8]

Two broad types of professional fee data were collected: debtor professional expenses and committee professional expenses. In particular, under section 330 of the Bankruptcy Code, all professionals retained by either the debtor or an official committee, most often a creditors committee, must file fee applications with the court before they can be paid from estate funds.[9] A similar rule applies to professionals retained by examiners or trustees, and the datasets also include that information. Bankruptcy-related professional fees incurred in the days just before the bankruptcy filing are reported on the debtor's statement of financial affairs and thus also are included in the present study. Professional fees incurred by creditors who have a contractual right to charge such fees to the debtor – such as secured lenders – are not included in this study, inasmuch as these sorts of reimbursement obligations are not subject to section 330 and are therefore not subject to express disclosure.

The present study modifies the original ABI dataset in several key respects. For example, in the original study cases were followed for two years or until they ceased to be in chapter 11 because either a plan was confirmed, the case was

---

[8] Section 304 was repealed in 2005 as part of the enactment of new chapter 15. Both section 304 and new chapter 15 deal with the recognition of foreign bankruptcy proceedings in the United States. *See* Jay Lawrence Westbrook *Chapter 15 at Last*, 79 AM. BANKR. L. J. 713 (2005).

[9] 11 U.S.C. §330.

converted to chapter 7, or the case was dismissed.[10] This approach to the data was necessitated by the required timeline for producing the final report under the ABI Chapter 11 Fee Study.

To examine whether this censoring had any effects on the data, I revisited the cases that were still pending in chapter 11 when the original study was completed and recoded them to include their final resolution and all professional expenses incurred through that resolution.

Additionally, I revamped my approach to measuring the debtor's assets and liabilities in the dataset. First, asset and liability information was taken from Bloomberg. Typically this information comes from the most recent pre-bankruptcy SEC filings, but Bloomberg also provides financial information for certain larger privately held companies in the sample (e.g., Tower Records).[11] Then, only if financial information on the debtor was unavailable on Bloomberg, assets and liability information was taken from the debtor's schedules. This change was done for a variety of reasons, most notably to reduce the risk that debtor size – a key factor in this study – would be miss-specified for the corporate groups in the dataset, since schedules are often filed on a corporation by corporation basis, whereas chapter 11 costs are typically incurred by the group as a whole.

Following these changes to the datasets, the dataset is comprised of 97 chapter 11 cases, all filed in 2004.

* * *

[10] The study captured professional fees incurred during the study period, even if approved or requested outside of the study period.

[11] 73.2% of the cases in the dataset are coded with Bloomberg information.

Bankruptcy financial advisors come in two broad types.[12] First there are the investment banker-type advisors, who either help market (i.e. find a buyer for) the debtor or advise the debtor on business changes going forward.[13] Alternatively, if retained by a committee they provide advice about the debtor's business prospects and the financial terms of the proposed plan. Second there are the accounting firms that act as financial advisors. They typically provide similar business advice to either the debtor or the committee that retains them, but are less likely to engage in direct efforts to sell the debtor. In addition, both types of financial advisor typically present valuation evidence at the hearing to consider a reorganization plan for the debtor.[14]

Somewhat related to the financial advisors are the turnaround consultants.[15] These are professionals retained by the debtor. Like financial advisors, they provide business advice to the debtor – indeed, some of the same firms act as financial advisors when retained by a committee. But these turnaround consultants typically

---

[12] *See* LYNN M. LOPUCKI & JOSEPH W. DOHERTY, *supra* note 5, at 117-18.

[13] Until 2005, these firms were typically not the large, well-known American investment banks, as the Bankruptcy Code expressly precluded retention of an investment banker that had been an underwriter for the debtor's securities. In addition, it should be noted that financial advisors retained in chapter 11 cases only rarely underwrite securities offerings, so some would argue they are not actually "investment bankers."

[14] For example, in all cases the debtor is required to prove that creditors are receiving at least as much as they would in a hypothetical chapter 7 liquidation. 11 U.S.C. §1129(a)(7). This requires the creation of a "liquidation analysis" and presentation of the same at the hearing. *See* Peter V. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 BUS. LAW 419 (1996).

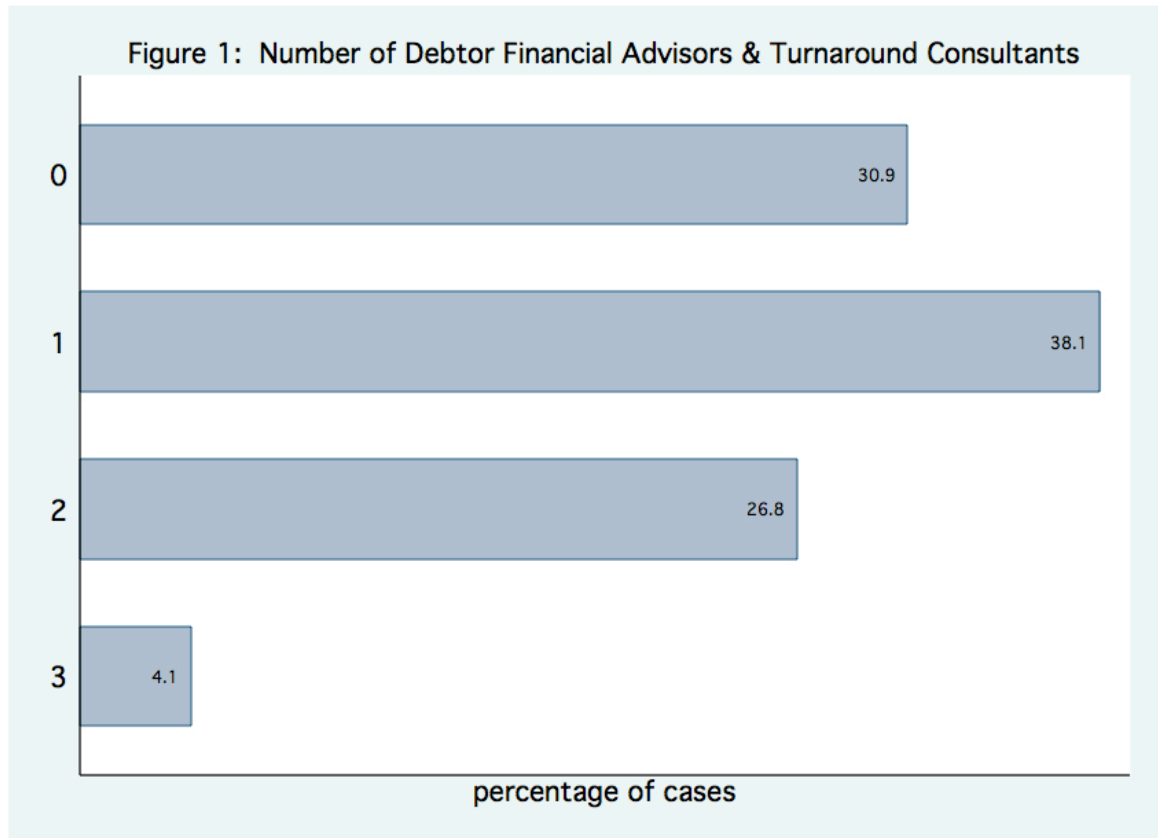
[15] The only other study of financial advisors in chapter 11 includes turnaround consultants among its definition of financial advisors. Lynn M. LoPucki & Joseph W. Doherty, *Rise of the Financial Advisors: An Empirical Study of the Division of Professional Fees in Large Bankruptcies*, 82 AM. BANKR. L. J. 141 (2008) [hereinafter, "LoPucki & Doherty (2008)"].

become more involved in the direct management of the debtor, often taking positions within the senior management of the debtor. In some instances, the retention of these firms is mandated by a senior lender or the lead lender for the group of banks in the debtor's secured credit facility. Appointment of a turnaround firm and a member of that firm as "chief restructuring officer" is sometimes the price for obtaining additional financing during a chapter 11 case.[16] In other cases, turnaround firms, despite their hopeful names, provide the management of a remnant debtor following an asset sale, liquidating unsold assets, and working toward a plan that will distribute the sale proceeds.

There are 33 turnaround firms retained in the present dataset, across 30 chapter 11 cases. That is, in three cases debtors retained two turnaround firms, while 27 debtors retained a single turnaround firm. 33 fee applications is often an insufficient number to analyze separately, but given the somewhat unique role these professionals play, it warrants accounting for their presence when considering the topic of financial advisors, broadly defined.

---

[16] Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1229 (2006).



II. Prevalence and Cost of Financial Advisors

As shown on Figure 1, almost 70% of the debtors, or 67 of 97 debtors, in the dataset retain at least one financial advisor or turnaround consultant, and an almost equal number retain more than one. Eleven debtors retained a turnaround consultant but no financial advisor.

In the dataset, 74 of the 97 cases have at least one committee. In 57 of these cases the committees retained at least one financial advisor.

Table 2 shows the relationship between retention of financial advisors by the debtor and its committees. Note that zero committee retentions on this table can

either mean there was no committee, which happened in 22 cases, or the committee retained no financial advisors, which happened in 18 cases, yielding the 40 total cases seen on the Table. Other than no financial advisors or turnaround consultants in the case whatsoever, the next most likely outcome is for the debtor and committee to each retain one financial advisor or turnaround consultant, followed closely by one committee retention and two debtor retentions.

Table 2: Number of Financial Advisors & Turnaround Consultants

	Retained by committees in case			
Retained by debtor in case	*0*	*1*	*2*	*Total*
0	24	6	0	30
1	12	22	3	37
2	4	19	3	26
3	0	2	2	4
Total	*40*	*49*	*8*	*97*

In eleven cases there was more than one committee appointed. In all of these cases the committees retained at least one financial advisor, and in six cases they retained two – most often with each committee retaining its own financial advisor. Multiple retentions of financial advisors by debtors do not seem to turn on the number of committees. For example, there are 26 cases where the debtor retained two or more financial advisors in cases with but a single committee.

If we limit our focus to the first committee appointed in the case – typically the basic unsecured creditors committee – in 51 cases that committee retained a single financial advisor, in four cases it retained two financial advisors.

Financial advisors – including turnaround consultants – are less likely to be retained by debtors in the smallest quartile of cases in the dataset. As shown on Table 2A, it also appears that multiple retentions are less likely to occur with respect to the smaller debtors.[17]

Table 2A: Combined Debtor and Committee Financial Advisor and Turnaround Consultant Retentions, by Debtor Size

	Number retained in case						
Debtor size by quartile	*1*	*2*	*3*	*4*	*5*	*6*	*Total*
(smallest) 1	8	3	1	0	0	0	12
2	7	7	4	1	1	1	21
3	3	7	9	3	0	0	22
4	4	4	10	1	2	0	21
Total	22	21	24	5	3	1	76

Cases with no retentions omitted

Table 3 shows the typical cost for financial advisors and turnaround consultants. For the 66 cases with at least one financial advisor or turnaround consultant, the extra cost associated with these averages $2.9 million, with a median cost of $1.6 million.[18] The debtor spends much more on these professionals than committees, with the average debtor spending $2.5 million as compared with $862,000 for committees. In other words, debtors spend an average of about three times as much on these professionals as committees do.[19]

[17] Cases with no financial advisors are omitted from the table to reduce the number of cells and increase the readability. Tables 2 and 2A will not match up exactly, since Table 2A includes cases without committees, unlike Table 2.

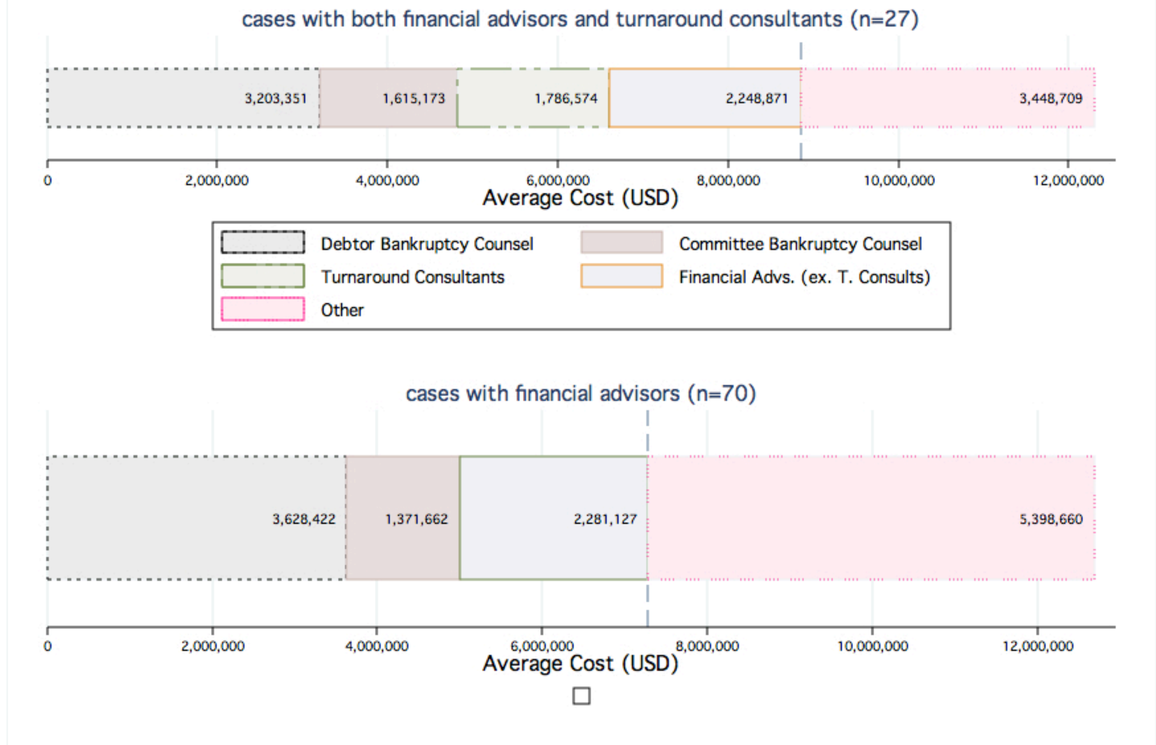
[18] The number of retained professionals in the following tables are often somewhat less than the total number of retentions discussed earlier, because in some cases the fee applications were missing from the docket. That is, in some cases I know a financial advisor or turnaround consultant was retained, but I do not know how much they were paid.

[19] Debtors spend 2.6 times as much on a median basis.

Table 3: Cost of Financial Advisors and Turnaround Consultants

	Obs	*Mean*	*Std. Dev.*	*Median*	*Min*	*Max*
Debtor FA	51	$1,966,577.00	$2,296,789.00	$1,406,436.00	$3,232.26	$10,400,000.00
Debtor TC	23	$2,113,132.00	$3,232,314.00	$1,010,300.00	$152,947.90	$15,800,000.00
Debtor Total	59	$2,523,684.00	$3,767,882.00	$1,512,281.00	$3,875.04	$24,500,000.00
Committee FA	53	$862,493.20	$868,316.80	$554,448.00	$4,025.00	$3,028,514.00
All combined	66	$2,948,628.00	$4,206,185.00	$1,615,799.00	$3,875.04	$26,900,000.00

As shown in the top graph in Figure 4, in cases with both turnaround consultants and financial advisors, these professionals constitute the biggest portion of overall cost save for debtor's counsel, although the very small number of such cases suggests the need for caution. With a sample size of 27, once cannot be entirely sure the sample is representative. As also shown on the same graph, these professionals combined with bankruptcy counsel for the debtor and committee make up more than 71% of the overall cost of such a case. Turnaround consultants account for 17.27% of total cost, while financial advisors account for 17.05% of total cost.



The bottom graph in Figure 4 shows cases with financial advisors, whether or not there was a turnaround consultant. In this larger group, financial advisors account for 18.2% of average cost, and together with the attorneys these three groups of professionals represent almost 60% of the average total cost in the chapter 11 case. Financial advisors, although receiving much attention and criticism, actually cost slightly less, on average, than the debtor's bankruptcy attorneys.

The remaining 40% of professionals are comprised of a variety of lawyers, accountants, and other professionals. Some, like appraisers and real estate professionals, may be directly involved in the bankruptcy cases, while others may be

exogenous to the bankruptcy process, like lawyers handling a specific piece of non-bankruptcy litigation or auditors that would have been retained even if there had never been a bankruptcy case. In the latter case, the professionals earn too much compensation to be retained under an ordinary course professionals motion.[20]

III. Modeling the Cost of Financial Advisors

In the only other attempt to model financial advisors costs in chapter 11, LoPucki & Doherty (2008) found that debtor size, filing in Delaware or New York, and the number of financial advisors retained in the case were the key factors ($p<0.05$) in predicting total financial advisor cost.[21] The authors also found that retention of KPMG LLP as a financial consultant reduced overall cost, although the implications of this finding are not discussed in the article.[22]

I begin by testing the LoPucki & Doherty (2008) model on my data, using the same factors save for KPMG retention. In LoPucki & Doherty (2008) all factors were positively related to total financial advisor cost, although time spent in chapter 11 was not significant. The authors report that Model II on Table 10 in LoPucki & Doherty (2008) resulted in an adjusted R-squared of 0.68.

---

[20] In larger cases, it has become common to excuse non-bankruptcy "ordinary course" professionals from the formal retention and fee approval system, although this practice is the subject of some controversy. Lynn M. LoPucki & Joseph W. Doherty, *Routine Illegality in Bankruptcy Court Fee Practices*, 83 Am. Bankr. L.J. 423 (2009); *see also* Martin J. Bienenstock et al., *Response to "Routine Illegality in Bankruptcy Court, Big-Case Fee Practices"*, 83 Am. Bankr. L.J. 549 (2009).
[21] The authors also found that their "trend" variable was significant ($p < 0.01$). The material presented in LoPucki & Doherty (2008) also appears in LOPUCKI AND DOHERTY, *supra* note 5, with some modifications and revisions.
[22] http://us.kpmg.com/services/content.asp?l1id=10&l2id=760.

When applied to the present dataset, the LoPucki model achieves an adjusted R-squared (0.431). The two jurisdictional variables are not significant.

On Table 5 I develop my own model. In the first model I consider debtor size. This should be positively related to cost, but consistent with my prior studies of other aspects of chapter 11 costs, I would expect debtor size to decrease in import as the models begin to address complexity and other factors more directly.[23]

In the second model I add a proxy for complexity, namely a dummy variable that indicates whether a claims agent was used in the case.[24] This should be positively correlated with cost.

In the third model, I add a dummy variable that indicates if both the debtor and the committees had at least one financial advisor. This reflects the insight from Table 5.1, which shows that there is often a kind of parallelism between debtor and committee retention of financial advisors. This variable thus indicates whether this is a case where this kind of joint retention is present.

Table 5.1: Number of Financial Advisors Retained

	Committees		
Debtor	*None*	*1 or more*	*Total*
None	26	15	41
1 or more	14	42	56
Total	40	57	97

[23] Stephen J. Lubben, *Corporate Reorganization & Professional Fees*, 82 Am. Bankr. L.J. 77 (2008); Stephen J. Lubben, *What We "Know" About Chapter 11 Cost is Wrong*, 17 Fordham J. of Corp. & Fin. L. – (forthcoming 2011).

[24] Ordinary course professional motions are not used in this chapter, inasmuch as the financial advisors and turnaround consultants, unlike attorneys, would not be much affected by such a motion.

In the final model I add the number of fee objections in the case to this model, log transformed and mean centered – that is, the mean is subtracted from every value.[25] I use this variable as an index of how contentious the case is, theorizing that these cases might be more likely to result in valuation disputes and other litigation and challenges to the financial advisors' work. The large lump sum fees that financial advisors and turnaround consultants receive might make them the likely targets of a case with more fee objections. And financial advisors typically pass on the cost of defending their retention and compensation in the bankruptcy court, which means that a more contentious case will result in another layer of attorneys' fees paid through the financial advisors' fee applications. By mean-centering the variable, the coefficient can now be interpreted as indicating the extra cost associated with above average "contentiousness." Cases with less than average contentiousness will have a negative value in this variable, which, combined with the positive coefficient shown on Table 5, results in lower overall financial advisor costs.

Throughout this paper I adjust the standard errors to account for potential, unseen correlations among cases within the same judicial district (*i.e.,* clustered standard errors).

[25] Log of a zero value is undefined. To account for the number of cases with zero objections, I also add a constant (0.001) to the total number of objections in all cases.

Table 5: Models of Total Financial Advisor Cost

	(1) Log of total TC & FA cost in case	(2) Log of total TC & FA cost in case	(3) Log of total TC & FA cost in case	(4) Log of total TC & FA cost in case
Log of debtor size	0.501*	0.317	0.234	0.236
	(0.185)	(0.173)	(0.136)	(0.124)
Claims agent		0.776**	0.566**	0.478**
		(0.258)	(0.197)	(0.173)
Both retained FA			0.844***	0.789***
			(0.197)	(0.172)
Log case objs, centered				0.142***
				(0.0381)
Constant	1.855	2.895*	3.181**	3.179**
	(1.521)	(1.321)	(1.004)	(0.930)
Observations	66	66	66	66
R^2	0.246	0.390*	0.567***	0.644***

Robust standard errors in parentheses; se adjusted for clustering by district; mean VIF (model 4) 1.21
* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The final model explains 64.4% of the variance in total financial advisor and turnaround consultant costs, comparable to the models described in LoPucki & Doherty (2008). The joint retention of financial advisors, case complexity, and the contentiousness of the case are all significant factors in the cost, after size and complexity are accounted for.

The first two models, which involve size and complexity, explain very little, which suggests most of the work is done by the variables added in the last two models.

IV. Debtors' Financial Advisors & Turnaround Consultants

As noted, the bulk of the cost associated with financial advisors comes from the debtor's side of the case. Similarly, turnaround consultants are a debtor-only phenomenon. Accordingly, I use this section to explore an extension of the model developed on Table 5 to the specific issue of debtor financial advisors and turnaround consultants.

Table 6: Number of Debtor Financial Advisors and Turnaround Consultants

	Financial Advisors				
Turnaround Consultants	*0*	*1*	*2*	*3*	*Total*
0	29	25	12	1	67
1	10	15	2	0	27
2	2	1	0	0	3
Total	41	41	14	1	97

Table 6 shows that while turnaround consultants and financial advisors are often retained by the same debtor, the two are largely independent. In 12 cases there were turnaround consultants without financial advisors, and in 38 cases there were financial advisors without turnaround consultants, in 13 cases there were multiple financial advisors without any turnaround consultants. And in 29 cases the debtor retained neither.

I model debtor financial advisor cost (Model 1) and the combined cost of debtor financial advisors and turnaround consultants (Model 2) on Table 7. In both cases I use a modified version of the final Model from Table 5, accounting for the change in dependent variables, which no longer includes committee financial advisors.

In particular, I enter measures of size, a proxy for complexity, and the measure of case contentiousness, the mean-centered number of fee objections in the case. I also use the dummy variable that indicates the retention of one or more turnaround consultants. In addition, in these models I use a variable that indicates if a committee was appointed in the case and another that counts the number of

debtor financial advisors. I hypothesize that all variables should be positively related to cost in either model.

Table 7: Models of Debtor Fin. Advisor & Turnaround Consultant Cost

	(1) Log of Debtor FA cost	(2) Log of Debtor TC & FA cost
Log of debtor size	0.435**	0.363***
	(0.142)	(0.0737)
Claims agent	0.119	0.169
	(0.217)	(0.150)
Number of debtor FAs	-0.102	-0.0252
	(0.176)	(0.131)
Turnaround consultant	0.0654	0.327*
	(0.250)	(0.157)
Log of objs, mean centered	0.143***	0.134***
	(0.0353)	(0.0352)
Committee	0.834*	0.670*
	(0.327)	(0.281)
Constant	1.540	2.139**
	(0.925)	(0.599)
Observations	49	57
R^2	0.691	0.681

Robust standard errors in parentheses; se adjusted for clustering by district; mean VIF 1.48 and 1.27, respectively.
* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The first model considers the cost of debtor financial advisors alone. Size, case contentiousness (number of fee objections), and an appointment of a committee are the key factors in this model. Interestingly, the number of debtor financial advisors is not significant, suggesting that it does not matter if the work is divided among multiple financial advisors. The appointment of a turnaround consultant also is not significant, suggesting that the cost of financial advisors is somewhat independent from the appointment of these related professionals.

The second model follows the LoPucki & Doherty (2008) approach and considers the two types of debtor professionals in the aggregate, using the same model. The turnaround advisor variable is now significant, which is to be expected as the difference in the two dependent variables is the turnaround consultant cost.

Interestingly, in both models size is significant again. This may suggest a debtor-specific effect that was hidden when considering the joint cost of financial advisors in Table 29. For example, there may be an unmodeled element of complexity here – larger debtors may engage their financial advisors in different ways than smaller debtors.

V. Financial Advisors & Turnaround Consultants in Chapter 11

The foregoing analysis highlights the importance of financial advisors and turnaround consultants in modern chapter 11 practice. A sample taken of cases filed in 2011 would undoubtedly show even more prevalence of these types of professionals. Nonetheless, these sorts of professionals were largely unknown when the Bankruptcy Code's professional retention and compensation provisions were drafted in the late 1970s.[26]

Thus, while section 328 allows some degree of flexibility with regard to the terms of retention, many still envision all bankruptcy professionals billing by the

[26] 11 U.S.C. §§ 327, 328, 330, 331. Remember, of course, that the Code of 1978 continued the New Deal suspicion of most large investment bankers, a prohibition largely removed by the 2005 Amendments to the Code. *See* 11 U.S.C. § 101(14). *See generally* Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 Cornell L. Rev. 1420 (2004) (discussion the history of corporate restructuring in the United States, which initially featured extensive involvement of investment bankers like JP Morgan).

hour and keeping the corresponding time records. Financial advisors work with a different model, that involves higher risk and correspondingly higher reward. They do not fit neatly into the existing scheme in the Bankruptcy Code.

Perhaps nowhere is that better illustrated than in the confusion surrounding section 328(a).[27] Many read this provision as limiting the court's ability to review compensation under section 330 at the end of the case.[28] For a financial advisor who may be compensated, at least in part, by a large success fee at the end of the case. The temptation to reconsider that success fee with the benefit of hindsight, and the knowledge of precisely how much it will be, may overwhelm the commitment to the fee that occurred at the start of the case.

Accordingly, courts have developed any number of elaborate rules regarding the invocation of section 328(a).[29] None of these find much support in the actual text of the Code. On the other hand, professionals sometimes speak of retention "under" section 328(a), as if this were a separate provision of the Code that would allow the professional to bypass the general scheme set forth in sections 327 and 330. But surely this is an impossibility, given section 328(a)'s express reference of section 327.

Section 328(a) should be involved in every retention application, inasmuch as retention involves not only checking for the kind of conflicts prohibited by

---

[27] 11 U.S.C. § 328(a).

[28] Diana G. Adams & Roberta A. DeAngelis, Does "Improvident" Mean "Immutable"?: The Standard of Review for Advisors' Professional Fees, 28-5 ABIJ 18 (2009) ("Investment bankers have historically sought employment under terms and conditions that fixed their compensation, pursuant to 11 U.S.C. §328(a).").

[29] In re Airspect Air, Inc., 385 F.3d 915, 921-22 (6th Cir. 2004); In re Circle K Corp., 279 F.3d 669, 674 (9th Cir. 2002); Zolfo, Cooper & Co. v. Sunbeam-Oster Co., 50 F.3d 253, 262 (3d Cir. 1995).

section 327(a) but also considering whether the terms of the engagement are reasonable. It is this latter factor that invokes section 328(a), whether or not the parties or the court expressly mentions it in the retention order.

In the case of attorneys, it is easy to understand the distinction between pre-retention analysis under section 328(a) and post-retention analysis under section 330.[30] In short, section 328 involves whether the hourly rate is reasonable, while section 330 involves consideration of whether the number of hours billed was reasonable.[31] The court approves the rate at the point of retention, and the total number of hours at the point of the fee application. The only point at which this division breaks down is when the rates previously approved must be reconsidered

---

[30] *See* Riker, Danzig, Scherer, Hyland & Perretti v. Official Comm. of Unsecured Creditors (In re Smart World Techs., LLC), 552 F.3d 228, 233 (2d Cir. 2009).

[31] 11 U.S.C. §330, governing compensation of officers, including professionals, provides in pertinent part:
(3) In determining the amount of reasonable compensation to be awarded to an examiner, trustee under chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--
(A) the time spent on such services;
(B) the rates charged for such services;
(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

because they prove to be "improvident in light of developments not capable of being anticipated at the time of the fixing of such [rates]."[32]

None of this works very will when applied to a lump sum bonus paid at the end of the case. The bonus is an abstraction at the start of the case, and at the end of the case there is no way to reasonably untangle the two types of reasonableness review. Reviewing the bonus for its reasonableness under section 330 inevitably impinges on issues that should have been settled under the structure set up by section 327 and 328.[33]

Given the data presented in this paper, it seems that it may be time to resolve these important questions through a general reconsideration of the Code's provisions regarding professional retention.

Conclusion

This paper examines the other big source of professional costs in chapter 11: financial advisors, and the subsidiary group of professionals known as "turnaround consultants." Almost 70% of the debtors, or 67 of 97 debtors, in the dataset retain at least one financial advisor or turnaround consultant, and an almost equal number retain more than one. Many committees also retained financial advisors.

For the 66 cases with at least one financial advisor or turnaround consultant, the extra cost associated with these averages $2.9 million, with a median cost of $1.6

[32] 11 U.S.C. §328(a).
[33] And thus leading to the confusion seen in cases like Comm. of Equity Sec. Holders of Federal-Mogul Corp. v. Official Comm. of Unsecured Creditors (In re Fed. Mogul-Global, Inc.), 348 F.3d 390, 397 (3d Cir. 2003), where section 328(a) is held to constrain the ex post analysis under section 330.

million. The debtor spends much more on these professionals than committees, with the average debtor spending $2.5 million as compared with $862,000 for committees. In other words, debtors are spending an average of about three times as much as committees on these professionals. Perhaps most importantly, this paper shows that the joint retention of financial advisors by the debtor and the committee results in increased cost.

The Bankruptcy Code as currently written has but limited capacity to adapt to these new developments. It might be time for an update.