

WHAT THE TURNAROUND PROFESSIONAL CAN DO
TO CONTROL FEES IN REORGANIZATION CASES

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Many people are of the view that professional fees are out of control in chapter 11 reorganization cases. Reasonable people can disagree with respect to the magnitude of the problem.

Whether abuse is rare or wide-spread, it makes sense to implement procedures to control professional fees in chapter 11 cases.

The turnaround expert is in a unique position to control professional fees. First, the turnaround expert is familiar with the chapter 11 process. Second, the turnaround expert is accustomed to implementing cost cutting procedures. Third, the turnaround expert can lead by example by taking reasonable compensation tied to the success of the reorganization. Fourth, the turnaround expert often can influence the retention of professionals. In this regard, the turnaround expert should not retain professionals who have a reputation for abusing the fee process. By abuse, we mean undertaking unnecessary projects, over-staffing necessary projects, lacking the expertise to solve problems expeditiously, or engaging in a course of conduct designed to foment litigation rather than to facilitate consensual resolution of problems.

Fifth, the turnaround expert can negotiate professional fee arrangements that are designed to protect the client.

In order to control costs, the turnaround expert should insist on a budget process whereby professionals are required to submit a budget that is approved by the client before work commences. The budget should propose specific projects to be undertaken, the purpose for which the project is undertaken, the professionals proposed to staff the project, and the anticipated costs and fees to accomplish the project. The turnaround expert can weed out projects that are unnecessary either from a legal or economic point of view. The expert also can segment projects into phases. If preliminary research bears fruit, the project can proceed; if not, the project will be terminated and costs avoided. Only if the project is authorized by the client in writing should the professional undertake the project. If the professional works on an unauthorized project, no compensation should be paid unless the client ratifies the project after the fact. If the professional exceeds the fee estimate, however, the professional's compensation should not be at risk as long as the client was informed of the cost overrun and approved it at an appropriate point along the way.

While these procedures may be easy to implement with respect to professionals who work for the turnaround expert, it will be harder to apply them to professionals who work for

various creditor groups. Nevertheless, the turnaround expert can communicate with credit managers, loan officers, and other business people to insist that they exercise some control over the process. It may be, however, that many credit managers are short sighted, particularly when the debtor pays for the creditors' professional fees. Some thought should be given to negotiating a cap on the creditors' professional fees beyond which creditors themselves will be required to pay their professionals. Alternatively, perhaps the estate can recoup some of the creditors' professional expenses out of distributions that otherwise would be made to creditors under a plan.

Many fees are incurred with respect to valuation disputes. The turnaround expert should insist that a data bank be prepared and shared among the various constituents. The data bank will contain historical information and should be updated periodically as the case progresses. Accountants and financial advisors should be required to confer in advance with respect to the format and contents of the data bank so that each team of professionals will not prepare its own separate data bank. Of course, it will be necessary to prepare and obtain confidentiality agreements to enable this procedure to work. If valuation disputes arise, the turnaround expert can work with the professionals to isolate disputed issues and proposed a method for resolution of the disputes.

A far more difficult issue is how the turnaround expert should deal with litigation. Professionals who are overly litigious can greatly increase the cost of a restructuring or reorganization. Once one party commences litigation, the other parties must respond in kind. Under the present system, apparently it is to the advantage of all professionals to prolong the process by pursuing litigation. To be sure, responsible professionals proceed to negotiate consensual restructurings or plans of reorganization and move onto the next case. Professionals who are less busy or more confrontational are more prone to litigate. The turnaround expert should give thought to whether mediation or arbitration can be used as an alternative to litigation. If so, a protocol should be established with creditors early in the process before disputes arise; perhaps a stipulation requiring alternative dispute resolution can be negotiated and approved by the Bankruptcy Judge to bind the parties to this procedure.

If the turnaround expert does not desire to use alternative dispute resolution techniques or the parties are not agreeable to using the same, the turnaround manager can still facilitate communications among the parties. By establishing regular communications procedures, the turnaround expert can create an environment conducive to negotiation rather than litigation. In this respect, it is quite important that the

business people become personally involved and direct the professionals rather than the other way around. The turnaround expert should communicate regularly with the chairman of the creditors' committee and with key secured creditor constituents.

With luck, a protocol can be established whereby the business people will engage in settlement discussions before litigation is commenced. In practice, the filing of a complaint often hardens the position of the parties, heightens distrust, and spawns further litigation.

Some will doubt whether turnaround experts will be motivated to implement these suggestions. Turnaround experts who get referrals from professionals may be reluctant to confront professional fee issues. Nevertheless, turnaround experts with established reputations will save money for the business and enhance the probability of success for the turnaround if they deal with these issues efficiently.

As with most ideas, however, fee procedures and controls can be counterproductive if pursued to excess. Often, the turnaround expert will not be in a position to evaluate the need for a project. Accomplishing certain projects early on in the reorganization process may eliminate the need for many more costly projects down the line. In this respect, the experienced turnaround manager will be able to gauge the entire chapter 11 process in deciding which projects to approve. The less

experienced turnaround manager should ask the professionals to describe projects spanning the chapter 11 process so that the manager may make an informed judgment. It is also useful for the turnaround expert to educate the professionals with respect to goals and timetables for the reorganization at hand.

A turnaround expert should recognize that professionals will be required to document the file with respect to suggestions they have offered that the turnaround manager has rejected. The parties should recognize that this process is necessary to address professional malpractice concerns and is not simply make work on the part of the professionals. By the same token, this does not mean that the turnaround manager has been second guessed or that the professionals are hiding behind the turnaround manager's decision.

Finally, the turnaround manager should recognize that professionals work as teams. In this respect, staff meetings within professional firms and among different sets of professionals are required to facilitate the chapter 11 reorganization process. Indeed appropriate coordinated supervision of junior professionals by senior professionals can reduce overall fees. The turnaround expert should try to develop ground rules with professionals respecting the frequency and length of these conferences.

As long as there are professionals, there will be allegations that professionals are charging unnecessary and excessive fees. The proficient turnaround expert can act to minimize this issue in a particular case by addressing the issue at the inception of the engagement and being vigilant throughout.

If this is done successfully, the entire turnaround profession will be better off and the public interest will be served as well.