



EMORY
LAW

Emory Bankruptcy Developments Journal

Volume 28
Issue 1 *A Tribute to Tony Alvarez II and Bryan
Marsal*

Article 5

2011

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Recommended Citation

Stephen J. Lubben, *The Chapter 11 Financial Advisors*, 28 Emory Bankr. Dev. J. 11 (2011).
Available at: <https://scholarlycommons.law.emory.edu/ebdj/vol28/iss1/5>

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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 debtor’s counsel might once have handled the bulk of the reorganization, the debtor now routinely retains specialized professionals to address specific aspects of its 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 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 vocal commentators on professional fees are also lawyers, in the form of law professors.⁵

* 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, 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, the NCBJ, or their members.

¹ See Jo Ann Brighton et al., *For Better or Worse: Chapter 11 in the Post-BAPCPA Downturn*, 7 DEPAUL BUS. & COM. L.J. 555, 578–79 (2009).

² *Id.*

³ See, e.g., *In re Hillsborough Holdings Corp.*, 125 B.R. 837 (Bankr. M.D. Fla. 1991) (disapproving interim fee applications submitted by Bear Stearns Co., Inc., the Committee’s financial advisor); Linda Sandler, *Lehman Pays Its Bankruptcy Advisers \$262.6 Million for 9 Months*, BLOOMBERG, July 9, 2009, 12:01 AM, <http://www.bloomberg.com/apps/news?pid=20601087&sid=apzbxu6eOxik> (describing the lucrative fees paid to the financial advisors of Lehman Brothers Holdings, Inc.).

⁴ Michael L. Cook & Stephen J. Lubben, *Retention, Payment, Ethical and Other Obstacles for Non-Legal Professionals in Chapter 11 Reorganizations*, in *ETHICS IN CONTEXT*, at 175, 181–82 (PLI N.Y. Practice Skills, Course Handbook Ser. No. 66, 1999) (“Courts throughout the country differ in their views of non-legal 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 See, e.g., LYNN M. LOPUCKI & JOSEPH W. DOHERTY, *PROFESSIONAL FEES IN CORPORATE BANKRUPTCIES: DATA, ANALYSIS, AND EVALUATION* 120 (2011) (“Financial advisors often do a substantial portion of their work prior to the filing of the petition. In some instances, they seek payment for that work after the filing of the petition. That practice is improper, both because the estate has no right or obligation to pay

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 Article begins the discussion by considering a sample of financial advisors involved in chapter 11 cases filed in 2004. Part I of the Article 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 it also provides a brief discussion of the types of professionals that routinely appear in chapter 11 cases beyond bankruptcy counsel. Among other things, Part II 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, 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.

Part IV of the Article 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 11.⁶ Here, the most interesting finding is that the size of the debtor matters, whereas 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 Article wraps up by considering the legal and policy implications of these findings. In particular, I note how poorly the Bankruptcy Code, as drafted in 1978, is suited to the types of compensation structures that financial advisors and turnaround consultants typically receive. Looking specifically at § 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.

pre-petition unsecured debt and because the court can award compensation only to 'a professional employed under [§] 327.'" (footnote omitted).

⁶ See *infra* Table 3.

I. THE DATASET

I begin with the dataset I collected for the American Bankruptcy Institute's (ABI) Chapter 11 Fee Study.⁷ This dataset includes cases that were originally filed in 2004, and the data within each case comes from publicly available court filings that were primarily collected from Public Access to Court Electronic Records (PACER).⁸

The dataset is non-random, comprising of nearly all 2004 bankruptcy cases listed in the "Major Bankruptcies" database on BankruptcyData.com.⁹ Excluded from the dataset are all cases initially filed under chapter 7 and never converted to chapter 11, along with all cases filed under former § 304 of the Bankruptcy Code.¹⁰

Two broad types of professional fee data were collected: debtor professional expenses and committee professional expenses. In particular, under § 330 of the Bankruptcy Code and under Federal Rule of Bankruptcy Procedure 2016, 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.¹¹ A similar rule applies to professionals retained by examiners or trustees,¹² and the datasets also include

⁷ The American Bankruptcy Institute's Chapter 11 Fee Study is available online. Stephen J. Lubben, *ABI Chapter 11 Fee Study* (Seton Hall Pub. Law Research Paper No. 1020477, 2007), available at <http://ssrn.com/abstract=1020477>. The study is extensively discussed in Stephen J. Lubben, *Corporate Reorganization & Professional Fees*, 82 AM. BANKR. L.J. 77 (2008) [hereinafter Lubben, *Corporate Reorganization*].

⁸ PACER is available at <http://pacer.psc.uscourts.gov/>. For more on conducting empirical research of bankruptcy cases through PACER, see Jay Lawrence Westbrook, *Empirical Research in Consumer Bankruptcy*, 80 TEX. L. REV. 2123, 2148 (2002).

⁹ New Generation Research, *Bankruptcy Search*, BANKRUPTCYDATA.COM, www.bankruptcydata.com/findabrtop.asp (last visited Aug. 12, 2011).

¹⁰ See 11 U.S.C. § 304 (2000), repealed by Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 802(d)(3), 119 Stat. 23, 146. Section 304 was repealed in 2005 as part of the enactment of the new chapter 15. See Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 AM. BANKR. L.J. 713, 718-20 (2005). Both § 304 and the new chapter 15 deal with the recognition of foreign bankruptcy proceedings in the United States. See generally *id.*

¹¹ 11 U.S.C. § 330(a)(1) (2006) (permitting a bankruptcy court to compensate professionals who have previously been retained by the estate); FED. R. BANKR. P. 2016(a) ("An entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file an application setting forth a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested.").

¹² 11 U.S.C. § 330(a)(1) (permitting fees for a professional person employed by a trustee subject to § 327). The Code does not expressly provide for an examiner to retain professionals, but courts have typically assumed they have such powers. 7 COLLIER ON BANKRUPTCY ¶ 1106.05[3] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011); see also *In re Mirant Corp.*, 354 B.R. 113, 147-48 (Bankr. N.D. Tex. 2006); *In re Southmark Corp.*, 113 B.R. 280, 281-82 (Bankr. N.D. Tex. 1990).

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 are also included in the dataset. 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 the dataset, inasmuch as these sorts of reimbursement obligations are not subject to § 330 and are therefore not subject to express disclosure.¹³

The present study modifies the original ABI dataset in several key respects. For example, in the original study, each case was followed for two years or until it ceased to be in chapter 11 because either a plan was confirmed, the case was converted to chapter 7, or the case was dismissed.¹⁴ I took this approach with the data due to the required timeline for producing the final report for the ABI Chapter 11 Fee Study.

To examine whether this censoring had any effect on the data, I revisited the cases that were still pending in chapter 11 when the original study was completed and re-coded them to include their final resolution and all professional expenses incurred through that resolution.¹⁵

Additionally, I revamped my approach to measuring the debtor's assets and liabilities in the dataset, which previously had been taken only from the debtor's schedules. First, when available, asset and liability information was obtained from Bloomberg Professional.¹⁶ Typically, this information came from the company's 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). 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 made for a variety of reasons, most notably to reduce the risk that debtor size—a key factor in the present study—would be misspecified 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.

¹³ These professionals are not retained by the estate and thus not subject to the terms of § 330(a)(1). Instead, their claim for compensation is folded into the creditor's overall claim against the estate. *See generally* *Travelers Cas. & Sur. Co. of America v. Pac. Gas & Electric Co.*, 549 U.S. 443 (2007) (allowing creditor's claim for attorney's fees under an indemnification agreement).

¹⁴ Lubben, *Corporate Reorganization*, *supra* note 7, at 79. The study "capture[d] professional fees incurred during the study period, even if approved or requested outside of the stud[y] period." *Id.* at 85–86.

¹⁵ *See id.* at 87–88 (discussing the censoring issue).

¹⁶ 73.2% of the cases in the dataset are coded with Bloomberg information.

With these changes, the dataset is now comprised of ninety-seven chapter 11 cases filed in 2004.

* * *

Bankruptcy financial advisors come in two broad types.¹⁷ First, there are 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.¹⁸ In addition to a debtor, a committee can also retain an investment banker-type advisor to provide advice about the debtor's business prospects and the financial terms of the proposed plan. Second, there are accounting firms that act as financial advisors. They typically provide similar business advice to the debtor or the committee that retains them, but they are less likely to engage in direct efforts to sell the debtor.¹⁹ In addition, both types of financial advisors typically present valuation evidence at a hearing to consider a reorganization plan for the debtor.²⁰

Somewhat related to financial advisors are turnaround consultants.²¹ 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

¹⁷ See LOPUCKI & DOHERTY, *supra* note 5, at 90–93.

¹⁸ Until 2005, these firms were typically not 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. See Miriam F. Miquelon-Weismann, *Selling Out Corporate Reform: Eliminating The "Disinterested Person" Requirement for Investment Bankers Advising Chapter 11 Debtors*, 2 N.Y.U. J.L. & BUS. 731, 736–47 (2006) (discussing the history of investment banker retention); Nancy B. Rapoport, *Enron and the New Disinterestedness—The Foxes are Guarding the Henhouse*, 13 AM. BANKR. INST. L. REV. 521 (2005) (discussing the 2005 change to the Code). 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."

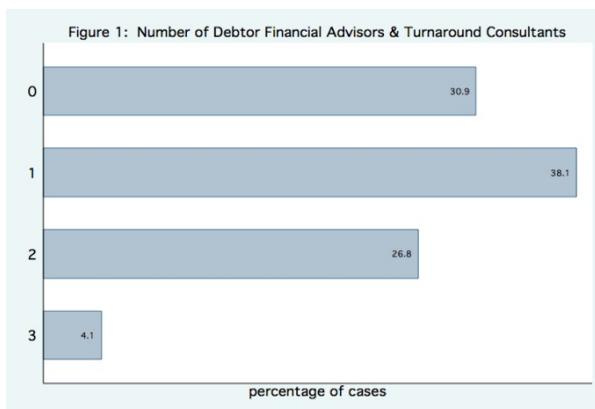
¹⁹ See Oscar Couwenberg & Stephen J. Lubben, *The Costs of Chapter 11 in Context: American and Dutch Business Bankruptcy*, 85 AM. BANKR. L.J. 63, 76 (2011) (describing the wide variety of professionals retained by debtors, including accounting firms who act as financial advisors); see also U.S. Trustee v. Price Waterhouse, 19 F.3d 138, 139 (3d Cir. 1994) ("[T]he debtors filed applications to employ Price Waterhouse as their accountant and financial advisor.").

²⁰ For example, in all chapter 11 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)(ii) (2006). This frequently involves hiring experts to create a liquidation analysis and present it at the hearing. See *id.* See generally Peter V. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 BUS. LAW. 419 (1996) (outlining techniques frequently used by valuation experts in bankruptcy cases).

²¹ 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, 142 (2008).

advisors when retained by a committee.²² These turnaround consultants typically become more involved in the direct management of the debtor, often taking positions within the debtor's senior management.²³ In some instances, the retention of these firms is mandated by a senior lender or the lead lender for the banks in the debtor's secured credit facility.²⁴ 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.²⁵ In other cases, a turnaround firm, despite its hopeful title, manages a remnant debtor following its asset sale, liquidating unsold assets and working toward a plan that will distribute the sale proceeds.²⁶

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



²² Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1234 (2006) (noting that Alvarez & Marsal serves as both an advisor to creditors and as a turnaround consultant).

²³ *Id.* at 1233.

²⁴ *Id.*

²⁵ *Id.*

²⁶ Such a turnaround firm is working on the remainders of Lehman Brothers. See Nelson D. Schwartz & Julie Creswell, *Who Knew Bankruptcy Paid So Well?*, N.Y. TIMES, May 2, 2010, <http://www.nytimes.com/2010/05/02/business/02workout.html>.

II. PREVALENCE & COST OF FINANCIAL ADVISORS

As shown in Figure 1, almost 70% of the debtors in the dataset, or sixty-seven of ninety-seven debtors, retain at least one financial advisor or turnaround consultant; an almost equal number retain more than one. Eleven debtors retained a turnaround consultant but no financial advisor. In the dataset, seventy-four of the ninety-seven cases have at least one committee. In fifty-seven 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 in this Table can either mean there was no committee, which happened in twenty-two cases, or the committee retained no financial advisors, which happened in eighteen cases; combining the two yields the forty total cases seen in the Table. Other than bankruptcies with no financial advisors or turnaround consultants involved 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

<i>Retained by debtor in case</i>	<i>Retained by committees in case</i>			<i>Total</i>
	<i>0</i>	<i>1</i>	<i>2</i>	
<i>0</i>	24	6	0	30
<i>1</i>	12	22	3	37
<i>2</i>	4	19	3	26
<i>3</i>	0	2	2	4
<i>Total</i>	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; 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 twenty-six cases with no committees appointed, yet in which the debtor retained two or more financial advisors.

If we limit our focus to the first committee appointed in the case—typically the basic unsecured creditors’ committee—that committee retained a single financial advisor in fifty-one cases, whereas it retained two financial advisors in four cases.

Financial advisors, including turnaround consultants, are less likely to be retained by debtors in the smallest quartile of cases in the dataset. As shown in Table 2A, it also appears that multiple retentions are less likely to occur with respect to the smaller debtors.²⁷

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

<i>Debtor size by quartile</i>	<i>Number retained in case</i>						<i>Total</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	
<i>(smallest)</i> 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
<i>Total</i>	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 sixty-six cases with at least one financial advisor or turnaround consultant, the extra cost associated with these professionals averages \$2.9 million, with a median cost of \$1.6 million.²⁸ 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 more than committees do on these professionals.²⁹

²⁷ Cases with no financial advisors are omitted from Table 2A to reduce the number of cells and increase readability. Tables 2 and 2A will not match up exactly, since Table 2A includes cases without committees, while Table 2 excludes cases without committees.

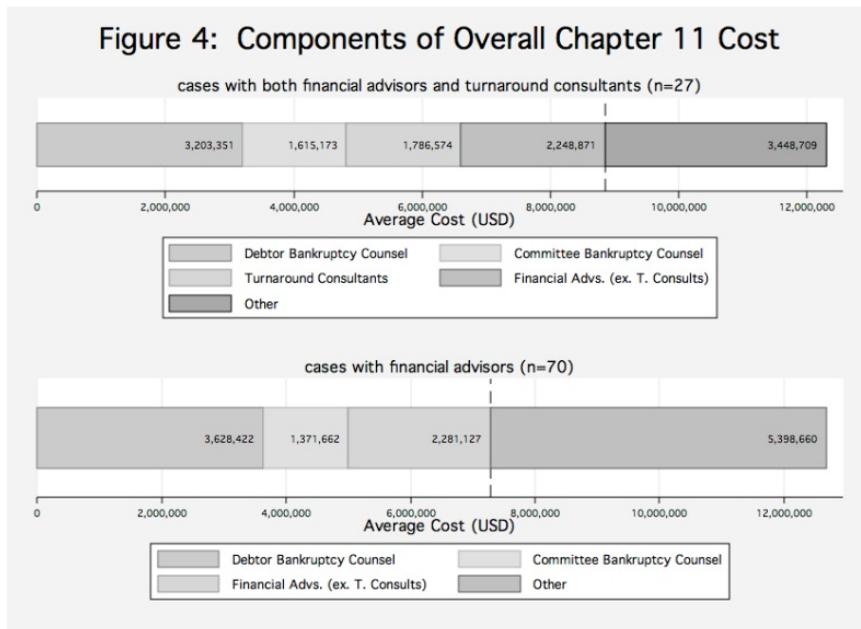
²⁸ The number of retained professionals in the following tables is somewhat less than the total number of retentions discussed earlier, because fee applications are missing from some case dockets. That is, I know a financial advisor or turnaround consultant was retained in some cases, but I do not know how much they were paid.

²⁹ Debtors spend 2.6 times more than committees on a median basis.

Table 3: Cost of Financial Advisors and Turnaround Consultants

	<i>Obs</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Median</i>	<i>Min</i>	<i>Max</i>
Debtor FA	51	\$1,966,577	\$2,296,789	\$1,406,436	\$3,232	\$10,400,000
Debtor TC	23	\$2,113,132	\$3,232,314	\$1,010,300	\$152,948	\$15,800,000
Debtor Total	59	\$2,523,684	\$3,767,882	\$1,512,281	\$3,875	\$24,500,000
Committee FA	53	\$862,493	\$868,317	\$554,448	\$4,025	\$3,028,514
All combined	66	\$2,948,628	\$4,206,185	\$1,615,799	\$3,875	\$26,900,000

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



The bottom graph of Figure 4 shows all cases with financial advisors, regardless of whether there was a turnaround consultant. In this larger group, financial advisors account for 18.2% of average cost, and together with the attorneys and turnaround consultants, these three groups of professionals represent almost 60% of the average total cost of chapter 11 cases. Financial advisors, although receiving much attention and criticism, actually cost slightly less, on average, than debtors' 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. Meanwhile, others may be exogenous to the bankruptcy process, like lawyers handling a specific piece of nonbankruptcy 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.³⁰

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 a case were the key factors ($p < 0.05$) in predicting total financial advisor cost.³¹ 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 their article.³²

I begin by testing the LoPucki & Doherty (2008) model on my data, using the same factors save for KPMG retention. In LoPucki & Doherty (2008), these factors were positively related to total financial advisor cost, although

³⁰ Martin J. Bienenstock et al., *Response to "Routine Illegality in Bankruptcy Court, Big-Case Fee Practices"*, 83 AM. BANKR. L.J. 549, 574 (2009) ("Ordinary course professionals' are professionals paid less than a fixed amount in a given month and with whom debtors frequently have prepetition, sometimes quite long-standing relationships for services unrelated to the debtor's Chapter 11 case."). In larger cases, it has become common to excuse nonbankruptcy "ordinary course" professionals from the formal retention and fee approval system, although this practice is the subject of some controversy. See Lynn M. LoPucki & Joseph W. Doherty, *Routine Illegality in Bankruptcy Court, Big-Case Fee Practices*, 83 AM. BANKR. L.J. 423, 430-43 (2009); see also Bienenstock et al., *supra*, at 574-76.

³¹ LoPucki & Doherty, *supra* note 21, at 160-62 & tbl.10. The authors also found that their "trend" variable was significant ($p < 0.01$). *Id.* at 160. The material presented in LoPucki & Doherty (2008) also appears with some modifications and revisions in LOPUCKI & DOHERTY, *supra* note 5.

³² See LoPucki & Doherty, *supra* note 21, at 162 tbl.10.

time spent in chapter 11 was not significant.³³ The authors reported that their model resulted in an adjusted R-squared of 0.68.³⁴

However, when applied to the present dataset, the LoPucki & Doherty (2008) model achieves an adjusted R-squared (0.431). The two jurisdictional variables are not significant.

In Table 5, I develop my own models. In the first model, I consider debtor size. This should positively relate to cost, but consistent with my prior studies on chapter 11 costs, I would expect debtor size to decrease in import as the models begin to address complexity and other factors more directly.³⁵

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. This too should positively correlate 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. Thus, this variable indicates whether this kind of joint retention is present.

**Table 5.1: Number of Financial Advisors Retained
Committees**

Debtor	<i>None</i>	<i>1 or more</i>	<i>Total</i>
<i>None</i>	26	15	41
<i>1 or more</i>	14	42	56
<i>Total</i>	40	57	97

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.³⁶ 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 over the financial advisors' work. The large lump sum fees that financial advisors and turnaround consultants receive might

³³ *Id.* at 160–62 & tbl.10.

³⁴ *Id.* at 162 tbl.10.

³⁵ See Stephen J. Lubben, *What We 'Know' About Chapter 11 Cost is Wrong*, 17 FORDHAM J. CORP. & FIN. L. (forthcoming 2011); Lubben, *Corporate Reorganization*, *supra* note 7, at 106, 110.

³⁶ 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.

make them the likely targets of a case with more fee objections.³⁷ And financial advisors typically pass on the cost of defending their retention and compensation in bankruptcy court, which means that a more contentious case will result in another layer of attorneys' fees paid through the financial advisor's fee applications.³⁸ 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 in Table 5, results in lower overall financial advisor costs.

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

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).³⁹ The joint retention of financial advisors, case complexity, and the contentiousness of the case are all significant factors in the cost, after accounting for size and complexity.

The first two models, which involve size and complexity, explain very little, suggesting that 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 in Table 5 to the specific issue of debtor financial advisors and turnaround consultants.

³⁷ See *In re Mirant Corp.*, 354 B.R. 113, 127 (Bankr. N.D. Tex. 2006).

³⁸ *In re Borders Grp., Inc.*, No. 11-10614, 2011 WL 3678171 (Bankr. S.D.N.Y. Aug. 23, 2011).

³⁹ See *supra* text accompanying note 31.

Table 5: Models of Total Financial Advisor Cost

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

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 6: Number of Debtor Financial Advisors and Turnaround Consultants

Turnaround Consultants	Financial Advisors				Total
	0	1	2	3	
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 although turnaround consultants and financial advisors are often retained by the same debtor, the two are largely independent. In twelve cases there were turnaround consultants without financial advisors; in thirty-eight cases there were financial advisors without turnaround consultants; in thirteen cases there were multiple financial advisors without any turnaround consultants. And in twenty-nine 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) in 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.

The first model considers the cost of debtor financial advisors alone. Size, case contentiousness (number of fee objections), and appointment of a committee are the key factors in this model. Interestingly, the number of debtor financial advisors is not significant, which suggests that it does not matter if the work is divided among multiple financial advisors. The appointment of a turnaround consultant is also 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 a single 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 5. For example, there may be an unmodeled element of complexity here—larger debtors may engage their financial advisors in different ways than smaller debtors.

Table 7: Models of Debtor Financial Advisor & Turnaround Consultant Cost

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

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

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 of cases filed in 2011 would undoubtedly show even more prevalence of these types of professionals.⁴⁰ Nonetheless, these sorts of professionals were largely unknown when the Bankruptcy Code's professional retention and compensation provisions were drafted in the late 1970s.⁴¹

⁴⁰ See LoPucki & Doherty, *supra* note 21, at 162–63 & tbl.11 (showing number of financial advisors increases with the assets of the debtor and the number of days spent in bankruptcy).

⁴¹ See 11 U.S.C. §§ 327–328, 330–331 (2006) (making no mention of financial advisors in the Code's retention and compensation provisions). Remember, of course, that the Code as enacted in 1978 continued the

Thus, while § 328 allows some degree of flexibility with regard to the terms of retention, many still envision all bankruptcy professionals billing by the hour and keeping the corresponding time records.⁴² Financial advisors work with a different model that involves higher risk and correspondingly higher reward.⁴³ They do not fit neatly into the existing Bankruptcy Code scheme.

Perhaps nowhere is this friction better illustrated than in the confusion surrounding § 328(a).⁴⁴ Many courts read this provision as limiting their ability to review compensation under § 330 at the end of a case.⁴⁵ 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.⁴⁶

Accordingly, courts have developed a number of elaborate rules regarding the invocation of § 328(a).⁴⁷ None of these rules finds much support in the

New Deal suspicion of most large investment bankers, a prohibition largely removed by the 2005 Amendments to the Code. *See id.* § 101(14) (lacking prior restrictions on participation of investment bankers as “disinterested person[s]”); *see also id.* § 101(14)(B)–(E) (2000) (amended 2005) (containing significant restrictions on involvement of investment bankers as disinterested persons); Miquelon-Weismann, *supra* note 18, at 736–47, 755–56 (2006) (discussing the history of the “categorical disqualification” of prepetition investment bankers as “disinterested persons” prior to 2005).

⁴² For example, in their recent book, LoPucki and Doherty frequently complain that some courts do not require such record keeping. LOPUCKI & DOHERTY, *supra* note 5, at xxiii.

⁴³ *See In re Bigler*, LP, 422 B.R. 638, 641–42 (Bankr. S.D. Tex. 2010).

⁴⁴ 11 U.S.C. § 328(a) (“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, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and 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.”).

⁴⁵ *See* Diana G. Adams & Roberta A. DeAngelis, *Does “Improvident” Mean “Immutable”? The Standard of Review for Advisors’ Professional Fees*, AM. BANKR. INST. J., June 2009, at 18, 78–79 (“Investment bankers have historically sought employment under terms and conditions that fixed their compensation, pursuant to 11 U.S.C. § 328(a).”).

⁴⁶ *See, e.g., In re Mirant Corp.*, 354 B.R. 113, 128–29 & n.35 (Bankr. N.D. Tex. 2006).

⁴⁷ For example, several courts have required varying degrees of “flag waiving” when a professional seeks to invoke the terms of § 328(a). *See, e.g., Nischwitz v. Miskovic (In re Airspect Air, Inc.)*, 385 F.3d 915, 921–22 (6th Cir. 2004) (requiring pre-approval of retention under § 328(a)); *Circle K Corp. v. Houlihan, Lokey, Howard & Zukin, Inc. (In re Circle K Corp.)*, 279 F.3d 669, 671 (9th Cir. 2001) (amended Jan. 30, 2002) (“[U]nless a professional’s retention application unambiguously specifies that it seeks approval under § 328, it is subject to review under § 330.”); *Zolfo, Cooper & Co. v. Sunbeam-Oster Co.*, 50 F.3d 253, 261 (3d Cir. 1995) (“If the order does not expressly and unambiguously state specific terms and conditions (e.g., specific

actual text of the Code. On the other hand, professionals sometimes speak of retention “under” § 328(a), as if this were a separate provision of the Code that would allow professionals to bypass the general scheme set forth in §§ 327 and 330.⁴⁸ But surely this is an impossibility, given § 328(a)’s express reference to § 327.⁴⁹ In short, the caselaw analysis of the interrelationship between §§ 327(a), 328(a), and 330 is nothing short of an intellectual mess.

Section 328(a) should be involved in every retention application, inasmuch as retention involves not only checking for the kind of conflicts prohibited by § 327(a), but also considering whether the terms of the engagement are reasonable. It is this latter factor that invokes § 328(a), whether the parties or the court expressly mention it in the retention order.

In the case of attorneys, it is easy to understand the distinction between pre-retention analysis under § 328(a) and post-retention analysis under § 330.⁵⁰ In short, § 328 involves whether the proposed hourly rate is reasonable,⁵¹ while § 330 involves consideration of whether the number of hours actually billed was reasonable.⁵² The court approves the rate at the point of retention and the

hourly rates or contingency fee arrangements) that are being approved pursuant to the first sentence of [§] 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).” (quoting *In re C & P Auto Transp., Inc.*, 94 B.R. 682, 685 n.4 (Bankr. E.D. Cal. 1988)).

⁴⁸ Courts also add to the confusion. *Donaldson Lufkin & Jenrette Secs. Corp. v. Nat’l Gypsum Co.* (*In re Nat’l Gypsum Co.*), 123 F.3d 861, 862 (5th Cir. 1997) (suggesting § 328 as a way to avoid § 330); *Nischwitz v. Airspect Air, Inc.* (*In re Airspect Air, Inc.*), 288 B.R. 464, 470 (B.A.P. 6th Cir. 2003) (“The widely accepted general rule is that bankruptcy courts, once having approved the employment under § 328, may not later switch to § 330 to award fees.”), *rev’d on other grounds*, 385 F.3d 915 (6th Cir. 2004); *In re Westbrook*, 202 B.R. 520, 522 (Bankr. N.D. Ala. 1996) (“If the bankruptcy court pre-approves the terms of the appointment, it does not have the power to make a ‘reasonableness’ review.”).

⁴⁹ See 11 U.S.C. § 328(a) (“The trustee, . . . with the court’s approval, may employ or authorize the employment of a professional person under [§] 327 or 1103 of this title . . .”).

⁵⁰ See *Riker, Danzig, Scherer, Hyland & Perretti v. Official Comm. of Unsecured Creditors (In re Smart World Techs., LLC)*, 552 F.3d 228, 233–34 (2d Cir. 2009) (drawing such a distinction).

⁵¹ See 11 U.S.C. § 328(a).

⁵² Section 330, which governs compensation of officers such as 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;

total number of hours at the point of the fee application.⁵³ The only instance in which this division breaks down is when the rates previously approved must be reconsidered because they prove to be “improvident in light of developments not capable of being anticipated at the time of the fixing of such [rates].”⁵⁴

However, this scheme does not work very well when applied to a lump sum bonus paid at the end of a case. The bonus is an abstraction at the start of the case, a percentage of an unknown number that will be paid at some unknown point the future, and at the end of the case there is no way to reasonably untangle the two types of reasonableness review.⁵⁵ Reviewing the bonus for its reasonableness under § 330 inevitably impinges on issues that should have been settled under the structure set up by §§ 327 and 328.⁵⁶

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

CONCLUSION

Studies of chapter 11 fees in the aggregate, and the chapter 11 fees of attorneys in particular, are common.⁵⁷ This Article 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 sixty-seven of ninety-seven 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.

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- (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.

Id. § 330(3).

⁵³ See *id.* §§ 328(a), 330(a)(3).

⁵⁴ *Id.* § 328(a).

⁵⁵ See *In re XO Commc’n, Inc.* 323 B.R. 330, 339 n.11 (Bankr. S.D.N.Y. 2005) (noting the court had approved the financial advisors’ monthly fees under § 328(a), but not the “success fee,” leaving the court free to consider the latter under § 330).

⁵⁶ And thus leading to the confusion seen in cases like *Committee of Equity Security Holders of Federal-Mogul Corp. v. Official Committee of Unsecured Creditors (In re Federal Mogul-Global, Inc.)*, 348 F.3d 390 (3d Cir. 2003), in which § 328(a) was held to constrain the ex post analysis under § 330. *Comm. of Equity Sec. Holders of Fed.-Mogul Corp. v. Official Comm. of Unsecured Creditors (In re Fed. Mogul-Global, Inc.)*, 348 F.3d 390, 396–403 (3d Cir. 2003).

⁵⁷ See Nancy B. Rapoport, *Rethinking Professional Fees in Chapter 11 Cases*, 5 J. BUS. & TECH. L. 263, 272–76 (2010) (reviewing the studies).

For the sixty-six 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. The debtor spends much more on these professionals than committees, with the average debtor spending \$2.5 million as compared to \$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 Article 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 is time for an update.