

# GAO Highlights

Highlights of [GAO-15-839](#), a report to the Chairman, Committee on the Judiciary, U.S. Senate

## Why GAO Did This Study

Since 2010, there have been at least 765 Chapter 11 bankruptcy filings by large companies. The associated fees for bankruptcy professionals, including attorneys, can run into the hundreds of millions of dollars. The size of these fees has raised questions about whether professionals have charged a premium for large bankruptcies and used the venue selection process to file in courts where they believed they would receive higher fees. The USTP, a Department of Justice component, is responsible for, among other things, reviewing whether fees requested by professionals in bankruptcy cases are reasonable and necessary in accordance with the Bankruptcy Code. In 2013, the USTP issued new guidelines governing its review of attorney fee applications in large Chapter 11 cases.

GAO was asked to review the USTP's 2013 guidelines. This report examines (1) the extent to which fee applications observed the 2013 guidelines and bankruptcy stakeholders' opinions regarding the guidelines' key provisions and their effects, and (2) what bankruptcy stakeholders and available research identify as contributing factors and effects of venue selection in large Chapter 11 cases. GAO conducted 57 nongeneralizable interviews with bankruptcy judges, attorneys, and AUSTs in 15 bankruptcy court jurisdictions responsible for large Chapter 11 cases. GAO also reviewed USTP data and court documents on cases subject to the 2013 guidelines, and relevant academic literature on professional fees and venue selection. The USTP generally agreed with GAO's findings.

View [GAO-15-839](#). For more information, contact David C. Maurer at (202) 512-9627 or [MaurerD@gao.gov](mailto:MaurerD@gao.gov).

September 2015

## CORPORATE BANKRUPTCY

### Stakeholders Have Mixed Views on Attorneys' Fee Guidelines and Venue Selection for Large Chapter 11 Cases

#### What GAO Found

GAO's analysis of U.S. Trustee Program (USTP) data and interviews with bankruptcy stakeholders including Assistant U.S. Trustees (AUST), selected bankruptcy judges, and attorneys indicate that attorneys' fee applications for cases subject to the USTP's 2013 fee guidelines (cases involving assets and liabilities each of \$50 million or more) have generally contained the information requested by the guidelines. This information is intended to assist the courts in determining whether requested fees are reasonable and necessary. Specifically, in the data GAO reviewed, the USTP identified no issues in submitted fee applications in 47 of the 94 cases filed since the guidelines went into effect in November 2013. Attorneys resolved almost all of the issues in the other 47 cases by providing an explanation or additional information. Bankruptcy stakeholders had mixed perspectives of the overall value of the guidelines and of their potential effect on the efficiency and transparency of the Chapter 11 bankruptcy process, or the fees awarded. Similarly, opinions regarding the effect of specific provisions of the 2013 guidelines also varied by group. For example, 15 of 18 AUSTs said the provision requesting that attorneys provide budgets was likely to have a positive effect on the fee review process, while 10 of 14 attorneys said it was unlikely to have an effect. For example, stakeholders with a positive view said the budgeting provision encourages early communication in a case, while those with a negative view said that the unpredictability of bankruptcy cases limit the value of a budget.

Bankruptcy attorneys and judges GAO interviewed and academic research identify several factors that contribute to venue selection—the process of choosing where to file. Companies filing for bankruptcy have several options available to them when determining the venue, or court, in which to file their case, including their place of incorporation, principal place of business or assets, or where an affiliate has filed a Chapter 11 case. The most frequently cited factors—prior court rulings, the preferences of lenders, and judge experience—all contribute to overall predictability in a case and can provide some insights into what to expect from a court as a case proceeds through the bankruptcy process. For example, knowing a judge's level of experience with large cases and how a court has ruled on certain matters can help an attorney advise a client about how a court is likely to respond to issues in a specific case. Eight of the 39 attorneys and judges GAO interviewed cited perceived court attitudes on professional fees as a significant factor in venue selection. Approximately 61 percent of large Chapter 11 bankruptcy cases filed since October 2009 were filed in two jurisdictions—the Southern District of New York (SDNY) and the District of Delaware (Delaware). Bankruptcy attorneys and judges and academic research identified both positive and negative effects of the concentration of cases in these two jurisdictions. The positive effect most commonly cited by attorneys and judges was the significant large case experience developed by judges in the SDNY and Delaware. In contrast, the negative effects most commonly cited by attorneys were the difficulty local bankruptcy firms face in maintaining a bankruptcy practice outside of the SDNY and Delaware and the lack of opportunity for courts outside of these jurisdictions to develop precedent and expertise.



Report to the Chairman,  
Committee on the Judiciary,  
U.S. Senate

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GAO was asked to review the USTP's 2013 guidelines. This report examines (1) the extent to which fee applications observed the 2013 guidelines and bankruptcy stakeholders' opinions regarding the guidelines' key provisions and their effects, and (2) what bankruptcy stakeholders and available research identify as contributing factors and effects of venue selection in large Chapter 11 cases. GAO conducted 57 nongeneralizable interviews with bankruptcy judges, attorneys, and AUSTs in 15 bankruptcy court jurisdictions responsible for large Chapter 11 cases. GAO also reviewed USTP data and court documents on cases subject to the 2013 guidelines, and relevant academic literature on professional fees and venue selection. The USTP generally agreed with GAO's findings.

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Bankruptcy attorneys and judges GAO interviewed and academic research identify several factors that contribute to venue selection—the process of choosing where to file. Companies filing for bankruptcy have several options available to them when determining the venue, or court, in which to file their case, including their place of incorporation, principal place of business or assets, or where an affiliate has filed a Chapter 11 case. The most frequently cited factors—prior court rulings, the preferences of lenders, and judge experience—all contribute to overall predictability in a case and can provide some insights into what to expect from a court as a case proceeds through the bankruptcy process. For example, knowing a judge's level of experience with large cases and how a court has ruled on certain matters can help an attorney advise a client about how a court is likely to respond to issues in a specific case. Eight of the 39 attorneys and judges GAO interviewed cited perceived court attitudes on professional fees as a significant factor in venue selection. Approximately 61 percent of large Chapter 11 bankruptcy cases filed since October 2009 were filed in two jurisdictions—the Southern District of New York (SDNY) and the District of Delaware (Delaware). Bankruptcy attorneys and judges and academic research identified both positive and negative effects of the concentration of cases in these two jurisdictions. The positive effect most commonly cited by attorneys and judges was the significant large case experience developed by judges in the SDNY and Delaware. In contrast, the negative effects most commonly cited by attorneys were the difficulty local bankruptcy firms face in maintaining a bankruptcy practice outside of the SDNY and Delaware and the lack of opportunity for courts outside of these jurisdictions to develop precedent and expertise.

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### Abbreviations:

ABI	American Bankruptcy Institute
AUST	Assistant U.S. Trustee
Delaware	District of Delaware
EOUST	Executive Office for U.S. Trustees
FJC	Federal Judicial Center
LEDES	legal electronic data exchange standard
NBC	National Bankruptcy Conference
SARS	Significant Accomplishments Reporting System
SDNY	Southern District of New York
SEC	Securities and Exchange Commission
UST	U.S. Trustee
USTP	U.S. Trustee Program

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September 23, 2015

The Honorable Charles E. Grassley  
Chairman  
Committee on the Judiciary  
United States Senate

Dear Mr. Chairman:

Since 2010, there have been more than 53,000 Chapter 11 bankruptcy filings, with approximately 765 by large companies with assets and liabilities each of \$50 million or more.<sup>1</sup> The fees for bankruptcy professionals associated with large cases, such as attorneys and financial advisers, can run into the hundreds of millions of dollars, in part because of the size and complexity of such cases. For example, professional fees awarded in the 2011 American Airlines Chapter 11 bankruptcy case—the second-largest airline bankruptcy—totaled more than \$375 million.<sup>2</sup> The size of these fees, particularly during the recent economic recession in the United States, has raised questions about whether bankruptcy professionals are charging a premium for representing companies in financial distress, despite requirements in the Bankruptcy Code that fees be reasonable, necessary, and market-based.<sup>3</sup> Additionally, concerns have been raised that bankruptcy professionals may be using the venue selection process (the process by which a debtor selects where to file) to file in courts where they believe they will receive higher fees. As a result of the venue selection process, the majority of large Chapter 11

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<sup>1</sup>Bankruptcy is a specialized federal court procedure designed to help individuals and businesses eliminate or restructure debts they cannot fully repay and help creditors receive some payment according to the U.S. Bankruptcy Code's priorities of distribution. See 11 U.S.C. §507. Business debtors (individuals or companies) seeking to reorganize their debts may do so under Chapter 11 of the Bankruptcy Code. 11 U.S.C. §§ 1101-1174. Reorganization under Chapter 11 allows debtors to continue some or all of their operations, subject to court supervision, as a way to satisfy creditor claims.

<sup>2</sup>At the time its bankruptcy petition was filed, AMR, the parent company of American Airlines, listed approximately \$54 billion in combined assets and liabilities. AMR is the second-largest airline bankruptcy and the 13th largest non-financial public bankruptcy filing since 1980.

<sup>3</sup>11 U.S.C. § 330(a).

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bankruptcy cases are adjudicated in two jurisdictions—the Southern District of New York (SDNY) and the District of Delaware (Delaware).<sup>4</sup>

The U.S. Trustee Program (USTP)—a component of the Department of Justice—seeks to promote the efficiency and protect the integrity of the federal bankruptcy system by acting as a watchdog for the public interest and ensuring compliance with applicable laws and procedures. As part of its oversight and enforcement responsibilities, the USTP reviews whether requested fee amounts are reasonable and necessary, and comments or objects as appropriate, though bankruptcy courts have the final authority to award fees.<sup>5</sup> If the USTP identifies a concern associated with a fee application it has reviewed, the USTP will generally seek more information from the professionals (what is known as an inquiry) before filing an objection, and the answers or information may resolve the USTP's need to object. In other instances, the USTP may file an objection with the court and then reach an agreement with the professional outside of court that resolves the objection. Ultimately, the court determines whether to award requested compensation and may reach a different conclusion than the USTP.

In accordance with amendments to the Bankruptcy Code, in 1996 the USTP published procedural guidelines for reviewing professional fee applications in bankruptcy cases.<sup>6</sup> These guidelines focus on ensuring that fee applications contain information that could assist courts in determining whether requested fees are reasonable.<sup>7</sup> Among other

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<sup>4</sup>Debtors have several options to determine the court, or venue, in which to file their bankruptcy case. 28 U.S.C. § 1408. In 2011, Members of Congress introduced legislation to amend the existing statute. See Chapter 11 Bankruptcy Venue Reform Act of 2011, H.R. 2533, 112th Cong.

<sup>5</sup>Under the Bankruptcy Code, attorneys and other professionals who provide services for the debtor and official committees may be paid from the bankruptcy estate—the pool of assets and monies otherwise available to pay creditors—but the attorneys and other professionals must first file applications to be paid with the court and have the court approve the payments. See 11 U.S.C. § 330-331; Fed. R. Bankr. P. 2016(a). The court may enter an order directing the bankruptcy estate to pay the fees if it determines that the applicant has shown that the requested fees and expenses comply with the Bankruptcy Code. See 11 U.S.C. § 330(a)(1).

<sup>6</sup>United States Trustees; Guidelines Relating to the Bankruptcy Reform Act of 1994, 61 Fed. Reg. 24889 (May 17, 1996).

<sup>7</sup>28 C.F.R. pt. 58, App. A (Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. 330).

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things, the information requested by the 1996 guidelines includes detailed billing information by activity categories, such as activities associated with employee benefit issues or tax analysis. In 2013, the USTP issued new guidelines governing its review of attorney fee applications in larger Chapter 11 bankruptcy cases.<sup>8</sup> According to senior USTP officials, the USTP began developing these additional guidelines in response to public concerns regarding the size of fees in large, well-publicized Chapter 11 bankruptcies, such as the Lehman Brothers bankruptcy, where total professional fees were widely reported to have exceeded \$2 billion. The additional USTP guidelines detail the criteria the USTP uses to review attorneys' fee applications and were designed, in part, to improve transparency and help ensure that fees in large Chapter 11 bankruptcy cases (defined as those cases involving assets and liabilities each of \$50 million or more) are comparable to fees charged outside of bankruptcy. From November 2013, when the new guidelines went into effect, through March 2015, 94 Chapter 11 bankruptcy cases met the asset and liability thresholds and were subject to the guidelines (guidelines cases). Like the 1996 guidelines, the 2013 guidelines focus on the disclosure of information that the USTP believes will better enable the court to determine whether requested fees are reasonable. In addition, the 2013 guidelines identify specific information the USTP believes is necessary to assess attorneys' fees in large cases, such as electronic billing data, budgets, and information about rates charged to nonbankruptcy clients.

Approximately 61 percent of the large Chapter 11 bankruptcies filed since October 2009 have been filed in the SDNY and Delaware, and many of the companies that filed for bankruptcy in these jurisdictions are headquartered elsewhere. For example, in 2009, General Motors, a company headquartered in Detroit, Michigan, filed for Chapter 11 bankruptcy in the SDNY. More recently, the Dallas, Texas-based energy company Energy Future Holdings filed for Chapter 11 bankruptcy in Delaware. Academics and lawmakers have raised concerns about the possible negative effects on the ability of smaller parties, such as employees and small business creditors, to participate in the bankruptcy process when a case is filed far from the company's home jurisdiction. Companies filing for Chapter 11 bankruptcy have several options available to them when determining the court, or venue, in which to file

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<sup>8</sup>Appendix B Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under United States Code by Attorneys in Larger Chapter 11 Cases, 78 Fed. Reg. 36248 (June 17, 2013).

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their cases.<sup>9</sup> Specifically, a company may file a Chapter 11 bankruptcy case in any venue where it is domiciled, which has been interpreted as the company's place of incorporation.<sup>10</sup> A company may also file where it maintains its residence or principal place of business (headquarters) or assets. Finally, a company may file in a court where an affiliate, such as a franchise or dealership related to the parent company, already has a Chapter 11 bankruptcy case pending.<sup>11</sup> For larger companies, each of the filing options allowed under the Bankruptcy Code may be in a separate venue. For example, a company headquartered in Los Angeles may be incorporated in Delaware, maintain its assets in New York, and have affiliates with pending bankruptcy proceedings in Chicago, allowing the company to file for bankruptcy in any of these locations.<sup>12</sup>

You requested that we review the USTP's 2013 guidelines and issues associated with the bankruptcy venue selection process. Specifically, this report addresses the following questions:

1. To what extent have bankruptcy attorneys observed the 2013 guidelines in fee applications, and what are the opinions of bankruptcy stakeholders, including attorneys, judges, and USTP officials, regarding the guidelines' key provisions and their effects?
2. What do bankruptcy attorneys, judges, and available research identify as factors that contribute to venue selection and the effects, if any, of venue selection in large Chapter 11 cases?

To address these questions, we reviewed the Bankruptcy Code and relevant bankruptcy filings related to professional fees and venue selection in Chapter 11 bankruptcy cases. We also reviewed the 1996 and 2013 USTP fee guidelines for Chapter 11 bankruptcy cases. We

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<sup>9</sup>28 U.S.C. § 1408.

<sup>10</sup>28 U.S.C. § 1408(1); *In re Segno Communications, Inc.*, 264 B.R. 501, 506 (Bankr. N.D. Ill. 2001).

<sup>11</sup>28 U.S.C. § 1408(2).

<sup>12</sup>A party who disagrees with the debtor's venue selection may file a motion to transfer the case to another jurisdiction. Motions to transfer venue occur infrequently. For example, according to information presented to the American Bankruptcy Institute (ABI) Commission to Study the Reform of Chapter 11, from 2006 through 2012, the Delaware court heard 13 motions to transfer cases to another venue and 9 of these motions were granted.

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analyzed USTP data related to Chapter 11 bankruptcy cases filed from October 2009 through March 2015 to identify USTP offices that had 5 or more large Chapter 11 cases filed during this time period. We selected this time period because it enabled us to identify case activity in the years both before and after the 2013 guidelines went into effect.<sup>13</sup> We used these findings to select a nongeneralizable sample of bankruptcy stakeholders to interview from 18 USTP offices and 15 corresponding U.S. Bankruptcy Courts. While the views expressed in these interviews do not represent those of all bankruptcy stakeholders, they provide valuable insights from stakeholders who have experience with large Chapter 11 bankruptcy cases and the 2013 USTP guidelines. We conducted 57 semistructured interviews with 18 Assistant U.S. Trustees (AUST), 25 U.S. Bankruptcy Court judges, and bankruptcy attorneys from 14 law firms that represented debtor companies in 1 or more of the 94 cases subject to the 2013 guidelines.<sup>14</sup> The AUSTs and judges represented all jurisdictions that had heard 5 or more large Chapter 11 bankruptcy cases since October 2009; however, not all had participated in a 2013 guidelines case.<sup>15</sup> We asked all stakeholders questions regarding the 2013 guidelines, but did not ask AUSTs questions related to venue selection because they do not have a role in that process. We also conducted interviews with Executive Office for U.S. Trustees (EOUST) officials, and selected U.S. Trustees (UST), academics, and industry stakeholders.<sup>16</sup>

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<sup>13</sup>Because the guidelines did not go into effect until November 2013, jurisdictions that have historically heard large cases may not yet have had a guidelines case. We wanted to capture these jurisdictions in our review along with those that have had a guidelines case.

<sup>14</sup>Each USTP field office has 1 AUST. We interviewed either 2 or 3 judges in each of the courts that had heard 15 or more large Chapter 11 cases since October 2009, and 1 judge in each of the remaining courts. The 25 judges we interviewed were selected by the Chief Judge from the 15 U.S. Bankruptcy Courts in our scope. We selected the 14 law firms from which we interviewed attorneys both to capture firms with large case experience and to provide variation in geographic location and case size.

<sup>15</sup>Thirteen AUSTs participated in a case subject to the 2013 guidelines. Eleven judges presided over 1 or more cases subject to the guidelines, while 14 judges had not yet been involved with a guidelines case. With the exception of 1 judge who had been appointed to the bench in 2013, all judges interviewed had presided over at least 1 case between October 2009 and October 2013 that met the guidelines' thresholds of assets and liabilities each of \$50 million or more.

<sup>16</sup>We identified relevant academics and industry stakeholders through referrals from agency officials and a literature search on professional fees and venue selection in Chapter 11 bankruptcy cases.

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To further address the first question, we reviewed data from the USTP's Significant Accomplishments Reporting System (SARS) on the USTP's objection and inquiry activities related to professional fees in guidelines cases filed from November 2013 through March 2015. We analyzed the objections and inquiry data to identify USTP actions related to the new provisions in the 2013 guidelines. To assess the reliability of these data, we interviewed officials responsible for entering and maintaining the data and reviewed internal documentation and guidance associated with data entry and internal review processes. We determined that the data were sufficiently reliable for our purposes. We also reviewed information collected by the EOUST about the 2013 guidelines to determine the extent to which attorneys filing fee applications in guidelines cases included information related to the 2013 guidelines' provisions. Finally, we reviewed local rules of bankruptcy practice for the 15 jurisdictions in our scope to determine whether they incorporated provisions of the 2013 guidelines.<sup>17</sup>

To further address the second question, we reviewed relevant academic literature on the factors that contribute to venue selection and the effects of the concentration of cases in the SDNY and Delaware. We reviewed the methodologies of these studies to ensure they were sound and determined they were sufficiently reliable for our purposes. To identify the basis for venue selection companies used when filing cases, we reviewed the bankruptcy filing petition and first day declaration for each of the 94 guidelines cases filed from November 2013 through March 2015.<sup>18</sup> Additional information about our scope and methodology is provided in appendix I.

We conducted this performance audit from November 2014 to September 2015 in accordance with generally accepted government auditing

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<sup>17</sup>Local rules refer to a particular set of rules for each federal jurisdiction that supplement the Federal Rules of Bankruptcy Procedure. Local rules reflect the courts' traditional authority to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.

<sup>18</sup>A first day declaration is an affidavit by a debtor company executive regarding the company's background and finances in support of the bankruptcy filing. First day declarations generally accompany first day pleadings, or first day motions, which are documents filed with the court at the outset of a bankruptcy case by debtors-in-possession seeking expedited relief, including court approval to continue certain operations, such as permission to pay prepetition payroll or to authorize maintenance of existing bank accounts.

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standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### Role of the U.S. Trustee Program in the U.S. Bankruptcy Process

The USTP is one of several federal agencies involved in the U.S. bankruptcy system, but is the only executive branch agency responsible for providing oversight of bankruptcy cases.<sup>19</sup> The agency consists of the EOUST, which provides general policy and legal guidance, oversees operations, and handles administrative functions; and 21 USTs who oversee 93 field office locations and supervise the administration of federal bankruptcy cases. Each of the field offices is managed by an AUST, who is responsible for day-to-day oversight of federal bankruptcy cases. In addition to fee review activity, the USTP also investigates and civilly prosecutes bankruptcy fraud and abuse; refers suspected criminal activity to the U.S. Attorney and other law enforcement partners; monitors and takes action to address the conduct of debtors, creditors, attorneys, credit counselors, and others; oversees private trustees; and ensures compliance with applicable laws and regulations in all bankruptcy cases, from individual consumer filings to large corporate reorganizations.

Six basic types of bankruptcy are provided for under chapters of the Bankruptcy Code, depending on factors such as whether the debtor is an individual, corporation, or municipality, and whether the debtor seeks to reorganize or liquidate existing assets and liabilities.<sup>20</sup> Table 1 shows the

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<sup>19</sup>Other federal entities involved in the U.S. bankruptcy system are all part of the judicial branch and include the 90 bankruptcy courts, the Administrative Office of the United States Courts, which provides the courts with central support functions; the Judicial Conference of the United States, which serves as the judiciary's principal policy-making body; and the Federal Judicial Center (FJC), which is the education and research agency for the federal courts. The judiciary's Bankruptcy Administrator Program is responsible for overseeing the six judicial districts in Alabama and North Carolina, and generally performs the oversight functions of the USTP in those districts. Other federal entities may be involved in the bankruptcy system as creditors or other litigants.

<sup>20</sup>See 11 U.S.C. ch. 7 (liquidation), 9 (municipality), 11 (reorganization), 12 (family farmers and fishermen), 13 (individual debt adjustment), and 15 (cross-border).

differences between the types of bankruptcy and whether the USTP is responsible for reviewing professional fee applications for that bankruptcy type.

**Table 1: Six Types of Bankruptcy**

Bankruptcy chapter	Type of debtor	Purpose of bankruptcy	United States Trustee Program reviews fee applications
Chapter 7	Businesses and individuals	Liquidation <sup>a</sup>	Yes
Chapter 9	Municipality	Reorganization <sup>b</sup>	No
Chapter 11	Businesses and individuals	Reorganization	Yes
Chapter 12	Family farmers and fishermen	Reorganization	Yes
Chapter 13	Individuals with regular income	Reorganization	Yes
Chapter 15	Cross-border cases	Incorporate model law on cross-border insolvency	No <sup>c</sup>

Source: GAO analysis of the Bankruptcy Code. | GAO 15-839

<sup>a</sup>Liquidation involves the sale of certain assets of the debtor, and the distribution of the proceeds to creditors in accordance with the priorities of the Bankruptcy Code; operations usually cease and assets are sold.

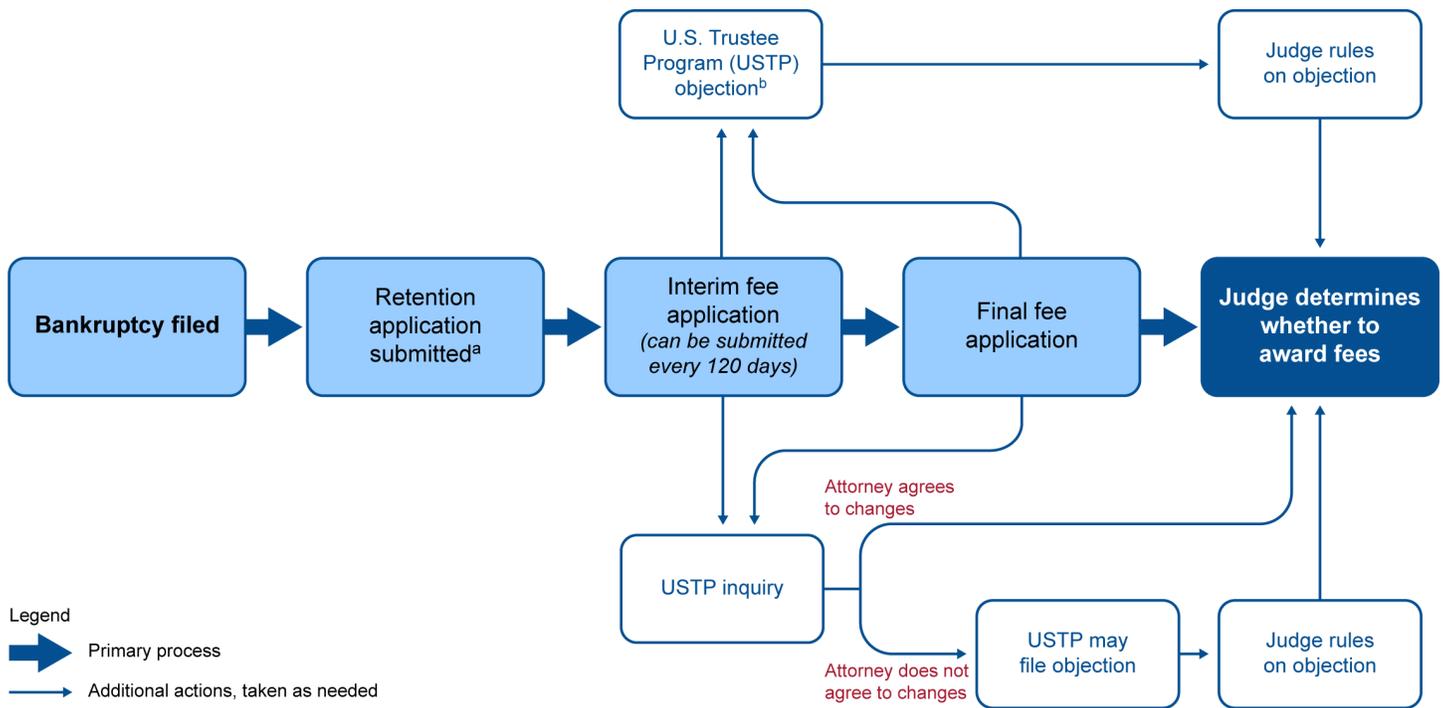
<sup>b</sup>Generally, reorganization occurs when a company or individual (or municipality in the case of Chapter 9) agrees with the creditors on a plan for payment of their claims; some plans may be approved without the creditors' consent in certain instances. In most instances, the company or individual emerges from bankruptcy after the plan is confirmed by the court.

<sup>c</sup>Generally, when the foreign proceeding is merely recognized in a U.S. federal bankruptcy court, fees are not awarded in connection with the U.S. proceeding. If, however, the foreign representative is permitted to file a case under Chapter 7 or 11 and files such a case in a U.S. bankruptcy court, then the foreign representative may seek compensation for fees in connection with the U.S. proceeding.

Per the Bankruptcy Code, the USTP is responsible for reviewing fee applications for five types of cases—cases under Chapters 7, 11, 12, 13, and 15 of the Bankruptcy Code.<sup>21</sup> According to USTP officials, the USTP's fee review responsibilities for Chapter 11 bankruptcy cases compose approximately 5 to 10 percent of the agency's activities, though the amount of time varies by office and the type of case. Figure 1 provides an overview of the fee application and review process in Chapter 11 bankruptcy, including cases subject to the 2013 guidelines.

<sup>21</sup>28 U.S.C. § 586(a)(3).

**Figure 1: Typical Attorney Fee Application and Review Process in Chapter 11 Bankruptcies**



Legend  
 ➡ Primary process  
 → Additional actions, taken as needed

Source: GAO. | GAO-15-839

<sup>a</sup>The USTP and other parties may also make inquiries or file objections with the court regarding retention applications. The judge must approve the retention application before fee applications may be submitted.

<sup>b</sup>This figure reflects additional actions that can be taken by the USTP as needed. Other parties may also file objections to fee applications with the court.

After a bankruptcy petition is filed, attorneys seeking to represent debtors or others must submit retention applications for approval by the court.<sup>22</sup> Once their retention is approved, attorneys seeking to be compensated from the estate (the pool of assets and monies available to pay creditors) may submit interim fee applications every 120 days, or more often if

<sup>22</sup>Under sections 327 and 1103 of the Bankruptcy Code, with limited exceptions, professionals employed in connection with a Chapter 11 case must be approved by the court. Professionals apply for employment through a retention application, which demonstrates that their services are necessary and that no conflicts of interest exist.

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permitted by the court.<sup>23</sup> The interim fee application allows attorneys to receive compensation for their work before the conclusion of the bankruptcy proceeding. At the conclusion of the case, attorneys submit a final fee application to the court. Both the USTP and the bankruptcy judge are responsible for ensuring that fees are reasonable and necessary, and may review any submitted documentation associated with fees to assist in that determination. While the USTP has standing to object to requested fees, the bankruptcy judge is responsible for determining the final fee amount to be awarded.<sup>24</sup> According to USTP officials, if the USTP identifies a concern associated with a fee application it has reviewed, such as staffing inefficiencies including duplication of work or requesting compensation for first-class travel, the USTP may seek to resolve it by informally contacting the firm submitting the application through an inquiry or by filing an objection to the fee application for the bankruptcy court to consider. Several factors influence how many inquiries and objections are made by the USTP offices in a given case with regard to professional fee applications. According to USTP officials, these can include the complexity of the case, the preferences of the court or USTP, or the experience of the firm filing the application. For instance, an experienced firm may be familiar with the USTP's expectations for fee applications, reducing the need for the USTP to request additional information.

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## Development of the 2013 Guidelines

The goals of the 2013 guidelines are to, among other things, help ensure attorneys' fees in bankruptcy cases are comparable to those charged for nonbankruptcy activities, increase the transparency and efficiency of the fee application and review process, and increase public confidence in the integrity of the process. As discussed previously, the USTP established fee review guidelines in 1996. The 1996 guidelines detailed the type of information and disclosures that the USTP expects professionals to include in their fee applications.<sup>25</sup> Like the 1996 guidelines, the 2013

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<sup>23</sup>11 U.S.C. § 331. Many bankruptcy courts allow firms, mostly in larger cases, to receive partial compensation (typically 80 percent of fees and 100 percent of expenses) on a monthly basis, with the remainder paid upon approval of the interim or final fee applications.

<sup>24</sup>Other parties, such as a fee examiner, fee committee, or other parties to the case may also review and object to submitted fee applications. However, according to USTP officials, the USTP is often the only party to object to fee applications.

<sup>25</sup>This includes, among other information, detailed billing information by activity categories, such as employee benefit issues or tax analysis, and standards for reimbursement of certain expenses, such as travel.

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guidelines are policies and procedures for USTP staff to follow when reviewing fee applications.<sup>26</sup> Unlike the 1996 guidelines, however, the 2013 guidelines apply only to attorneys' fee applications in Chapter 11 cases where the debtor's bankruptcy petition lists assets and liabilities each of \$50 million or more.<sup>27</sup> In addition to the provisions detailed in the 1996 guidelines, the 2013 guidelines outline the USTP's expectations that attorneys provide the following information in their fee applications:

- information about the firm's blended hourly rates for nonbankruptcy activities (comparable billing rates);<sup>28</sup>
- budgets and staffing plans, to include explanations when fees requested exceed the budget by 10 percent;
- electronic billing data, generally in the form of LEDES (legal electronic data exchange standard) data;
- client and applicant statements on issues including customary billing rates, fees, or terms of service; and
- disclosures regarding rate increases.<sup>29</sup>

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<sup>26</sup>The 1996 and 2013 guidelines are not law, and accordingly, are not binding on courts, debtors, or attorneys.

<sup>27</sup>In some cases, the asset and liability information provided on the bankruptcy petition is insufficient for the USTP to determine whether the 2013 guidelines will apply. In these cases, the USTP will rely on other information, such as Securities and Exchange Commission (SEC) filings, to determine whether the case meets the thresholds. The 2013 guidelines' thresholds also apply to aggregated assets and liabilities for jointly administered cases. The 1996 guidelines remain in effect for other professionals' fee applications in large cases, single-asset real estate cases, and smaller Chapter 11 cases. According to EOUST officials, the USTP is in the process of reviewing the guidelines for other types of bankruptcy professionals.

<sup>28</sup>Blended hourly rates are calculated for all employees at a particular level (such as partner or associate) by dividing the dollar value of hours billed by the total number of hours billed during the time period covered by the fee application. Firms may exclude pro bono, charitable, or firm-employee engagements that were never contemplated to be billed at or near standard or full rates.

<sup>29</sup>The 2013 guidelines also encourage the use of efficiency co-counsel for routine legal tasks to minimize costs, provide models for using fee examiners or fee committees, and provide model forms for applicants to use when submitting the newly required information. See app. II for the USTP's summary of material differences between the 1996 and 2013 guidelines.

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According to senior USTP officials, the USTP began to develop the 2013 guidelines in 2010 in an effort to address concerns about the size of attorneys' fees in large Chapter 11 cases. The 2013 guidelines were also intended to update the USTP's fee review practices to better reflect advancements in law firm billing practices and technology. To develop the 2013 guidelines, officials created an internal working group and sought input from bankruptcy stakeholders, such as judges, legal industry groups, and attorneys. The USTP published drafts of the guidelines on its public website for public comment in November 2011 and November 2012, and received more than 30 comment letters in response.<sup>30</sup> The USTP also held a public meeting on June 4, 2012, on the draft guidelines.

Two of the newly proposed provisions—the comparable billing rate provision and the budgeting and staffing plan provision—were frequently discussed in the comment letters and during the public meeting. According to an EOUST official, the comparable billing rate provision received the most commentary during the public comment period and meeting and was therefore revised more extensively than other provisions. For example, the comment letters from the National Bankruptcy Conference (NBC) and a letter signed by 119 bankruptcy law firms identified several concerns with the draft guidelines' proposal requesting the "highest, lowest, and average hourly rates" charged by firms for all activities. Among these was the concern that such detailed information about the highest and lowest rates billed does not accurately compare with a firm's "customary compensation charged," which is the standard identified by the Bankruptcy Code.<sup>31</sup> The NBC also submitted a separate comment letter proposing multiple alternatives for the USTP to consider. Similarly, comment letters from both the NBC and the 119 law firms expressed concerns regarding the draft budgeting provision, particularly with regard to the public disclosure of budgets. After incorporating changes and clarifying provisions based on the public

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<sup>30</sup>The guidelines are not subject to the notice and comment provisions of the Administrative Procedure Act (5 U.S.C. § 553), but the agency chose to develop the guidelines through a similar process because of their importance to the bankruptcy system.

<sup>31</sup>For instance, the letter from the 119 law firms argues that a firm's highest and lowest rates cannot be considered "customary" compensation, as they are charged specifically in situations that are not customary. These situations could include negotiated premiums for results obtained (resulting in high rates) or special discounts provided for certain types of work (resulting in low rates).

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comments, including allowing redaction of sensitive budgetary information and removing the requirement to disclose the highest and lowest rates billed, the USTP published the final guidelines in the *Federal Register* in June 2013 and they went into effect in November 2013.<sup>32</sup>

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## Attorneys Generally Observed the 2013 Guidelines; Opinions Regarding Their Effects Vary by Stakeholder Group

Our analysis of USTP data and interviews with bankruptcy stakeholders (AUSTs, judges, and attorneys) indicate that attorneys' fee applications for guidelines cases have generally contained the information requested by the 2013 guidelines. Bankruptcy stakeholders we interviewed had mixed perspectives on the overall value of the guidelines and on their potential effect on the efficiency and transparency of the Chapter 11 bankruptcy process, or the fees awarded. Similarly, opinions regarding the effect of specific provisions of the 2013 guidelines—including provisions on electronic billing, budgeting and staffing plans, and comparable billing rates—also varied by group.

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## Attorneys Generally Observed the 2013 Guidelines

Analysis of USTP data and interviews with bankruptcy stakeholders indicate that attorneys' fee applications for guidelines cases (those cases with assets and liabilities each of \$50 million or more) have generally contained the information requested by the 2013 guidelines.<sup>33</sup> For the 94 guidelines cases filed from November 2013 through March 2015, our analysis of USTP data found that the USTP did not make any inquiries or objections related to the guidelines for fee applications in half (47) of the cases. For the other 47 cases, the USTP identified issues in submitted fee applications that were associated with the guidelines, almost all of which were related to three provisions: (1) budgeting and staffing plans,

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<sup>32</sup>Appendix B Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under United States Code by Attorneys in Larger Chapter 11 Cases, 78 Fed. Reg. 36248 (June 17, 2013).

<sup>33</sup>One provision of the 2013 guidelines—the requirement that applicants provide statements about customary billing rates, fees, or terms of service—also applies to retention applications. According to EOUST officials, as a result of the guidelines, attorneys have disclosed “bankruptcy premiums” or the removal of pre-existing client discounts after the client filed for bankruptcy. In 1 case, officials stated that following a USTP inquiry based on the guidelines, attorneys reinstated the pre-bankruptcy discount for the debtor, thereby saving the estate approximately \$1.3 million. EOUST officials stated that they have not quantified the results of the disclosure provision across all guidelines cases. We did not review inquiry and objection data regarding retention applications.

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(2) comparable billing data, and (3) electronic billing records. Specifically, in 36 guidelines cases, the USTP made 98 inquiries and objections, 90 of which were related to one or more of these three provisions in the 2013 guidelines.<sup>34</sup> For example, in one fee application, a firm requested an hourly rate that was higher than the comparable rate it charged in nonbankruptcy activities and exceeded its budget in certain project categories. Because the firm did not provide any explanation in its original fee application, the USTP informally raised the issues with the firm, which then provided an explanation in supplementary information filed with the USTP and the court. In total, attorneys were able to resolve 92 of the 98 inquiries and objections to the satisfaction of the USTP. Almost all were resolved by the attorney providing an oral or written explanation or by filing supplementary information.<sup>35</sup> An internal spreadsheet maintained by the EOUST to provide additional oversight of the 2013 guidelines' implementation noted compliance issues in 11 other guidelines cases. Attorneys in 10 of these 11 cases also addressed the USTP's concerns by providing supplemental information or agreeing to do so in future cases.<sup>36</sup>

Bankruptcy stakeholders we interviewed who had participated in at least 1 guidelines case also reported that fee applications filed by attorneys in those cases generally contained information requested by the 2013 guidelines. Of the 57 bankruptcy stakeholders we interviewed, 38 had participated in at least 1 guidelines case.<sup>37</sup> Of these 38, 29 reported that

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<sup>34</sup>Ninety-five inquiries related to the guidelines were made in 35 cases, while 3 objections related to the guidelines were made in 1 case. The USTP made these inquiries and objections in part because the submitted fee applications did not contain all of the information requested by the 2013 guidelines.

<sup>35</sup>As of March 2015, 6 inquiries had not yet been resolved. Although reducing attorneys' fees is not a stated goal of the 2013 guidelines, 15 inquiries that contained issues associated with the guidelines resulted in fee reductions of approximately \$113,000.

<sup>36</sup>According to EOUST officials, the guidelines-related issues identified in these 11 cases were not captured in the USTP's formal case data because the spreadsheet is an informal tool the EOUST uses to identify emerging issues and compliance patterns in the implementation phase of the 2013 guidelines. As a result, certain issues of oversight interest to the EOUST may not qualify or otherwise be significant enough to warrant a formal entry in the USTP data system. Additionally, selected provisions associated with the guidelines, such as a client's process for managing legal fees, may be captured under categories other than professional compensation in the formal data system.

<sup>37</sup>All 14 attorneys, 13 of 18 AUSTs, and 11 of 25 judges had participated in at least 1 guidelines case.

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fee applications filed by attorneys in the case or cases they were involved in had at least partially observed the 2013 guidelines. Two judges we interviewed stated that in the fee applications they reviewed for guidelines cases they presided over, attorneys did not observe the guidelines' provisions. Seven stakeholders could not comment on whether fee applications in the guidelines cases they participated in had observed the guidelines.<sup>38</sup> As discussed earlier in this report, the 2013 guidelines are not law, and accordingly, are not binding on courts, debtors, or attorneys. Of the 25 judges we interviewed, 6 noted they were likely to use some, but not all, of the 2013 guidelines' provisions when reviewing fee applications. For example, 1 judge stated that she would not require attorneys to provide budgets or staffing plans in their fee applications, but does expect that other provisions of the guidelines, such as electronic billing data, will make her review of fee applications easier. Another 9 judges said they did not intend to use the guidelines when reviewing fee applications. Specifically, 6 of these judges noted that their fee reviews would instead be guided by their courts' local rules. As 1 judge explained, his court's local rules already require all the information he needs to review fee applications.

Our analysis of the local rules for the 15 jurisdictions in our scope shows that 1 jurisdiction, the District of Nevada, generally incorporates USTP fee guidelines, while 14 jurisdictions do not.<sup>39</sup> EOUST officials reported that as of December 2014, another 14 bankruptcy courts outside the scope of our report have at least partially adopted the 2013 guidelines.<sup>40</sup> However, whether or not a jurisdiction has adopted the guidelines or a judge has chosen to use them to inform his or her own fee review does not preclude

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<sup>38</sup>Specifically, 1 judge said he could not comment on the observation of the guidelines because he does not use them. Another 3 stakeholders noted that fee applications had not yet been submitted in their respective cases, and 1 AUST explained that while his office was responsible for a guidelines case, he had recently been appointed and had not participated in the fee application review. One AUST and 1 judge noted that the guidelines case they participated in was not properly identified initially by the USTP as a guidelines case and consequently, the guidelines were not applied.

<sup>39</sup>The District of Nevada incorporates USTP fee guidelines in their local rules without specifically referencing either the 1996 or 2013 guidelines. A list of the jurisdictions in our scope can be found in app. I.

<sup>40</sup>According to EOUST officials, 3 courts have specifically adopted the 2013 guidelines as of December 31, 2014. As of that date, 12 other courts had existing local rules that adopted USTP fee guidelines generally and did not limit the applicability of the local rule to the 1996 guidelines.

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the USTP from implementing the guidelines' provisions and commenting or objecting to fee applications, as the USTP deems appropriate. As the EOUST Director explained, the 2013 guidelines communicate to professionals and the general public the criteria used by the USTP in the review of fee applications and the USTP's expectations of professionals. According to the USTP's implementing guidance provided to staff, in most cases, the agency should not object to an attorney's fee application based on noncompliance with the 2013 guidelines, and should instead reference the relevant provision in the Bankruptcy Code. However, the USTP can reference the provisions of the guidelines when reaching out to attorneys through an informal inquiry. Further, despite the reluctance of some judges to use the 2013 guidelines in their own review of fee applications, all 14 attorneys said that they included the information requested by the guidelines in relevant fee applications they submitted. Specifically, 5 of the attorneys noted that they try to maintain a good relationship with the USTP, and there is no reason not to comply with the 2013 guidelines.

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## Opinions Regarding the 2013 Guidelines Vary by Stakeholder Group

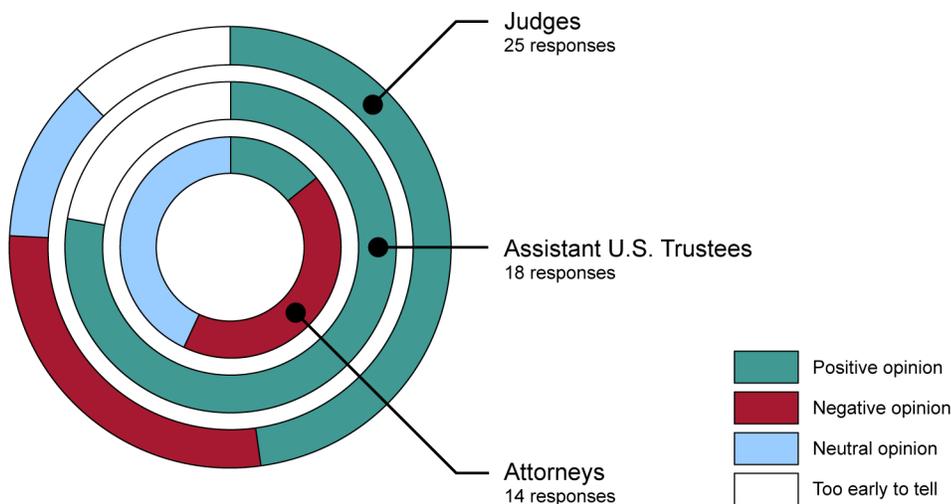
### Overall Opinion of the 2013 Guidelines

Bankruptcy stakeholders' perspectives on the overall value of the 2013 guidelines varied according to stakeholder group. Fourteen of 18 AUSTs, who oversee day-to-day activities associated with implementing the 2013 guidelines, viewed the guidelines positively, noting, for example, that the additional information requested by the guidelines will allow them to more easily determine whether fees are reasonable. The remaining 4 AUSTs stated it was too early for them to have an opinion about the guidelines overall.

In contrast, of the 14 attorneys we interviewed, 6 held negative, 6 held neutral opinions of the guidelines, and 2 expressed a positive opinion of the guidelines. The six attorneys with negative opinions of the guidelines commented that the 2013 guidelines impose significant additional work for them to prepare fee applications without providing a commensurate benefit to the bankruptcy process. One attorney with a neutral opinion explained that while he was not sure whether the guidelines would be able to accomplish their objectives, complying with them had not required much additional work. One attorney with a positive opinion said the 2013 guidelines are generally straightforward and easy to follow.

Judges' opinions regarding the overall value of the guidelines were also mixed.<sup>41</sup> Of the 25 judges we interviewed, 12 stated that their overall opinion of the guidelines was positive, 7 stated that their overall opinion was negative, 3 stated it was neutral, and 3 stated that it was too early to have an opinion.<sup>42</sup> Of the 12 judges who expressed a positive opinion of the guidelines, 4 noted that the guidelines will be useful in reviewing fee applications. In contrast, 5 of the 7 judges who had a negative opinion of the guidelines commented that they believed the guidelines were unnecessary. As one of these judge said, the new provisions do not address the issues that create problems with professional fees. Specifically, he explained that the guidelines do not prevent cases from "going off the rails," or experiencing unexpected setbacks, which is when problems with professional fees can arise. Figure 2 shows the opinions of each stakeholder group.

**Figure 2: Bankruptcy Stakeholders' Opinions of the U.S. Trustee Program's 2013 Guidelines**



Source: GAO. | GAO-15-839

<sup>41</sup>Eleven judges had presided over 1 or more guidelines case, and 14 judges had not yet been assigned a guidelines case.

<sup>42</sup>Two of the 12 judges who had a positive opinion of the guidelines also noted that it was too early to tell whether specific aspects of the guidelines would have a positive effect.

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Overall Effect of the 2013 Guidelines on Transparency, Efficiency, or Fees

Bankruptcy stakeholders also had mixed opinions, which varied by stakeholder group, regarding the effect of the guidelines on transparency, efficiency, or fees.<sup>43</sup> Specifically, 15 of 18 AUSTs reported that they thought the guidelines were likely to have a positive effect on transparency, efficiency, or fees.<sup>44</sup> In contrast, 9 of the 14 attorneys we interviewed said the guidelines were unlikely to have an effect on transparency, efficiency, or fees, in part because they believed the process that existed before the 2013 guidelines was already very transparent. Four of 14 attorneys stated that they believed the guidelines would increase transparency, but 3 of the 4 noted that the guidelines would not improve the efficiency of cases or reduce the fees awarded. For example, 1 attorney explained that the best way to reduce fees in bankruptcy is to improve efficiency to reduce the overall time a case takes to complete, and he was not sure whether the 2013 guidelines would be able to do so. The judges were split in their opinions—11 of 25 responded that the guidelines were likely to have a positive effect on transparency, efficiency, or fees, and 10 of 25 responded that they were not likely to have an effect.<sup>45</sup> For example, 1 judge said the 2013 guidelines would improve efficiency and transparency, making it easier for her to review and analyze fee applications. In contrast, another judge said she did not believe the guidelines would have an effect on the status quo, because attorneys already bill at market rates.

Effect of Selected Provisions of the 2013 Guidelines

The effects or potential effects of three provisions of the 2013 guidelines—(1) electronic billing records, (2) comparable billing rate information, and (3) budgeting and staffing plans—were discussed most frequently by bankruptcy stakeholders during our interviews.<sup>46</sup> Similar to

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<sup>43</sup>Not all stakeholders commented on the effects of the guidelines on all three aspects. We focused on these three aspects because two of the stated goals of the 2013 guidelines are to increase the transparency and efficiency of the fee review process, and, as discussed earlier in this report, EOUST officials reported that concerns about professional fees in large cases such as Lehman Brothers provided the impetus for developing the new guidelines.

<sup>44</sup>The 3 remaining AUSTs noted it was too early for them to have an opinion.

<sup>45</sup>In addition, 1 judge responded that the guidelines could have a positive effect on fees, but noted that they would not have an effect on transparency. Three of 25 judges responded that it was too early to tell what effect, if any, the guidelines might have.

<sup>46</sup>We did not specifically ask stakeholders about their opinion on each provision in the 2013 guidelines; therefore, not all stakeholders commented on specific provisions.

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the overall opinions of the guidelines, perspectives on the effects of these three provisions varied by stakeholder group.

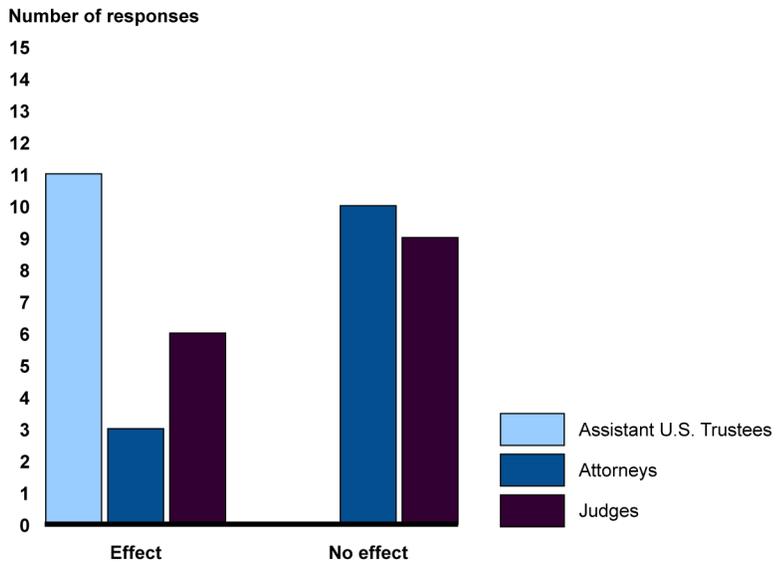
1. Electronic billing records: This provision was developed to bring the USTP's procedures into line with modern nonbankruptcy billing technology and practice.<sup>47</sup> The electronic billing records provision was cited by 22 of 43 AUSTs and judges as a provision likely to have a positive effect on the fee review process, in part because it will make the fee review process easier or more efficient. Only 2 attorneys mentioned the electronic billing record provision, and they noted that it was unlikely to have an effect.<sup>48</sup>
2. Comparable billing rate information: This provision was developed to provide specific information about rates, in an effort to increase transparency and improve comparability between rates charged for bankruptcy and nonbankruptcy activities. The comparable billing rate information was cited by 20 of 57 bankruptcy stakeholders we interviewed as a provision likely to have an effect on the fee review process, with 8 of these stakeholders noting that this provision was likely to have a positive effect by increasing transparency. In contrast, 19 of 39 attorneys and judges reported that the comparable billing rate provision was unlikely to have an effect on the fee review process. For example, 5 judges and attorneys explained that the comparable billing information is unnecessary because rates charged in bankruptcy are already comparable to rates charged for nonbankruptcy activities, while another 6 said that trying to compare rates charged in bankruptcy with nonbankruptcy rates is "comparing apples to oranges" and is not a meaningful way to determine reasonable fees. See figure 3 for a breakdown of responses by stakeholder group.

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<sup>47</sup>Prior to the 2013 guidelines, attorneys were not required to provide billing data in a searchable electronic format, such as an Excel file.

<sup>48</sup>One attorney explained that his firm had already provided these data to clients before the 2013 guidelines. Another said he felt the new requirement allowed the USTP to further analyze billing data, but that in his opinion, the billing information provided under the 1996 guidelines was sufficient.

**Figure 3: Bankruptcy Stakeholders' Opinions of the Comparable Billing Rate Provision of the U.S. Trustee Program's 2013 Guidelines**

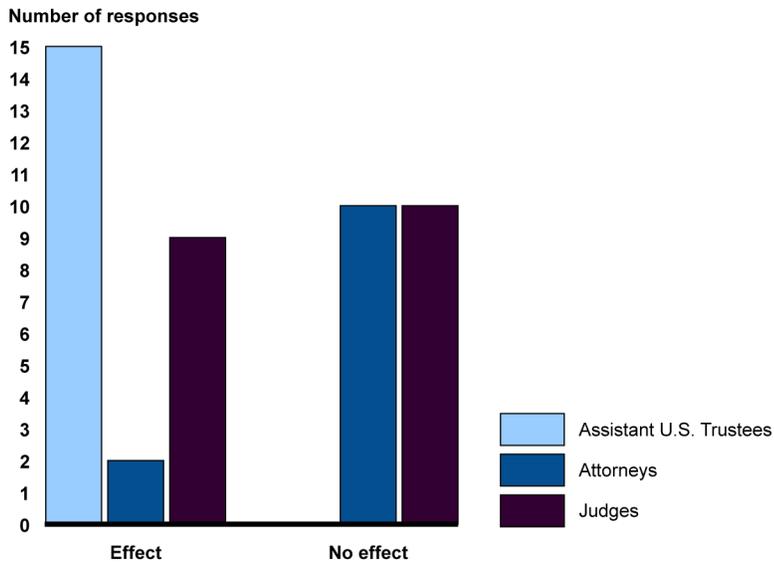


Source: GAO. | GAO-15-839

3. Budgeting and staffing plans: This provision was developed to encourage firms to apply standard management and planning tools to bankruptcy cases, as is done in other types of cases, in an effort to increase transparency. The budget and staffing plan provision of the 2013 guidelines was cited by 26 of the 57 bankruptcy stakeholders we interviewed as a provision likely to have a positive effect on the fee review process.<sup>49</sup> For example, stakeholders noted that the primary benefit of the budgeting and staffing provision is that it encourages attorneys to communicate, early in the case, information about the potential costs. In contrast, 16 of the 20 attorneys and judges who noted that the budgeting provision is unlikely to have an effect explained that bankruptcy cases are unpredictable, a fact that limits the value of a budget. See figure 4 for a breakdown of responses by stakeholder group.

<sup>49</sup>This provision requests information about agreed-upon budgets and staffing plans for the period covered by the fee application. The guidelines allow attorneys to change budgets as necessary, but ask for an explanation when billed fees exceed the budgets by 10 percent.

**Figure 4: Bankruptcy Stakeholders' Opinions of the Budget and Staffing Plan Provision of the U.S. Trustee Program's 2013 Guidelines**



Source: GAO. | GAO-15-839

## Bankruptcy Attorneys, Judges, and Academic Research Identify Contributing Factors and Effects of Venue Selection

Bankruptcy attorneys and judges we interviewed, and academic research we reviewed, identified several factors that contribute to venue selection.<sup>50</sup> The most frequently cited factors—including prior court rulings, the preferences of lenders, and judge experience—all contribute to overall predictability in a case and can provide some insights into what to expect from a court as a case proceeds through the bankruptcy process.<sup>51</sup> Bankruptcy attorneys and judges we interviewed and academic research we reviewed also identified both positive and negative effects of the concentration of cases in the SDNY and Delaware.

<sup>50</sup>We did not ask AUSTs questions related to venue selection and its effects as they do not have a role in that process.

<sup>51</sup>We asked the 14 attorneys and 25 judges we interviewed their opinions on four factors that we previously identified as potentially contributing to venue selection in large Chapter 11 bankruptcies: judge experience, prior court rulings, court administrative capacity, and perceived court attitudes related to professional fees. Interviewees also cited two additional factors that they perceived as contributing to venue selection.

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## Bankruptcy Attorneys and Judges Identified Several Factors that Contribute to Venue Selection

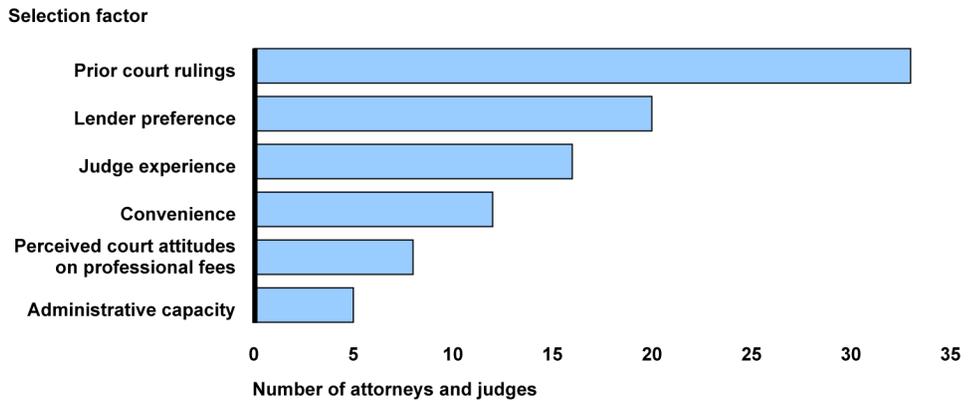
Bankruptcy attorneys and judges identified several factors that contribute to venue selection, or why a case may be filed in one court versus another. As discussed previously, companies filing for bankruptcy have several options available to them when determining the court, or venue, in which to file their case, including their place of incorporation, principal place of business or assets, or where an affiliate has filed a Chapter 11 bankruptcy case. The factors cited most frequently by the 39 attorneys and judges we interviewed as significant to venue selection include prior court rulings, the preferences of lenders, and judge experience.<sup>52</sup> While no two cases are exactly alike, these factors were frequently discussed as important because of how they contribute to predictability in a case.<sup>53</sup> For example, knowing a judge's level of experience with large cases and how a court has ruled on certain matters can help an attorney advise a client about how a court is likely to respond to issues in a specific case. Attorneys and judges also mentioned other factors that can contribute to venue selection, such as perceived court attitudes on professional fees, convenience or proximity of the parties involved in a case to the court, and court administrative capacity, though the majority said that professional fees and court administrative capacity were either minor factors or not a factor in venue selection. See figure 5 for the frequency with which the various factors were cited.

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<sup>52</sup>Both stakeholder groups identified the same top three factors that contribute to venue selection. The preferences of lenders refers particularly to the preferences of secured lenders. Secured lenders are lenders or creditors who have a mortgage or lien against a company and are the first to be repaid by the debtor. Secured lenders are often banks or other lenders, such as hedge funds, that provide liquidity to companies in financial distress.

<sup>53</sup>Thirty-six of 39 attorneys and judges cited at least one of the three key factors discussed above. Of those, 24 noted that these factors were important in venue selection because of their contribution to predictability. Two judges also discussed the importance of predictability in general, without specifying the factors that contribute to predictability. Overall, 26 attorneys and judges discussed the importance of predictability in venue selection.

**Figure 5: Factors Identified as Significant or Most Important in Selecting Venue by the 39 Bankruptcy Attorneys and Judges Interviewed**



Source: GAO. | GAO-15-839

## Prior Court Rulings

Thirty-three of the 39 attorneys and judges we interviewed cited prior local or circuit court rulings as a significant factor when selecting the venue in which to file a large Chapter 11 bankruptcy case, in part because understanding prior court rulings allows attorneys to better predict and advise clients on the possible outcomes of a case.<sup>54</sup> For example, 1 attorney explained the importance of prior court rulings, noting that attorneys look at district and circuit court opinions to determine what is favorable for their particular client and what will matter for the particular case. Specifically, 6 of the 33 attorneys and judges stated that it is the attorney’s responsibility to act in the best interest of his or her client, and understanding prior court rulings and how they relate to venue selection is part of that. Two of these attorneys further commented that filing in a court without taking into account prior rulings could harm a company’s ability to successfully emerge from bankruptcy and could be considered malpractice.<sup>55</sup>

<sup>54</sup>Nine of the 33 attorneys and judges specifically noted that prior court rulings were primarily important in terms of the predictability they offered.

<sup>55</sup>For example, companies with intellectual property licenses may be affected by a Ninth Circuit ruling that says a company cannot assume its patent license upon emerging from bankruptcy without the consent of the licensor. According to 1 attorney we interviewed, this raises concerns that the licensor could increase the cost of the license or reject it outright, which could negatively affect the company’s operations.

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Lender Preference

Twenty of the 39 attorneys and judges cited the preferences of lenders as a significant factor. As 3 attorneys we interviewed explained, lenders who provide financing to a company in distress may incorporate clauses in their financing agreements requiring the company to file in a certain jurisdiction. Nine of the 20 attorneys and judges noted that lenders incorporate such clauses because they prefer the predictability offered by certain courts. For example, 1 attorney stated that lenders may prefer the certainty of providing debtor financing in courts that have done hundreds of similar financing arrangements so that they know what motions are likely to be approved. According to 4 attorneys and judges we interviewed, other reasons that lenders may prefer certain jurisdictions can include the proximity of the court to their business operations.

Judge Experience

Sixteen of the 39 attorneys and judges cited judge experience as a significant factor in venue selection. Of these, 6 attorneys and judges stated that judge experience plays a key role in providing predictability in a case. As 1 judge explained, speaking from experience as a bankruptcy attorney, judge experience is very much a factor in venue selection and attorneys consider the competence and experience of judges on Chapter 11 matters when advising their clients. However, 6 other attorneys and judges said that in their opinion, all bankruptcy court judges are capable of handling large cases.

Professional Fees

Eight of the 39 attorneys and judges we interviewed identified perceived court attitudes on professional fees as a significant factor in venue selection. For example, 1 judge said that certain courts have a reputation for not approving fees over a certain amount and attorneys know which judges are “hard on fees.” In addition to the 1 attorney and 7 judges who identified fees as a significant factor, another 3 attorneys and 11 judges identified fees as a minor factor. In contrast, the majority of attorneys (10 of 14) and 7 of 25 judges said that professional fees were not a factor in venue selection. One attorney noted that he has tried cases in venues around the country and has not seen a difference in fees awarded. Five

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attorneys and judges said that professional fees may have played a bigger role in venue selection in the past.<sup>56</sup>

## Other Factors

Twelve of 39 attorneys and judges cited convenience or proximity of the parties involved to the court as a factor in venue selection. Five attorneys and judges also discussed the administrative capacity of the court, or the court's ability to process large cases, as a significant factor. However, the majority of respondents (29 of 39) said that administrative capacity was either a minor factor or not a factor.<sup>57</sup>

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## Academic Findings Reflect the Venue Selection Factors Reported by Stakeholders

Academic studies we reviewed on venue selection used various methodological approaches to identify several of the factors raised by the stakeholders we interviewed, though the importance of these factors varied across the studies.<sup>58</sup> For example, four studies, from 2002, 2004, and 2005, cited judge experience or the perceived expertise of the judge, or prevailing court rulings, as key factors in venue selection.<sup>59</sup> According to one academic expert we interviewed, judge expertise was likely a consideration for General Motors and Chrysler in choosing to file for bankruptcy in New York because they were more likely to be assigned an experienced judge in New York than in Detroit, where their headquarters

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<sup>56</sup>Although the stakeholders we interviewed did not elaborate on why they thought this was the case, a new recommendation included in the 2013 guidelines could contribute to this perception. The 2013 guidelines state that the USTP will not object if attorneys request fees associated with the rate charged in the jurisdiction where their firm is located, regardless of the jurisdiction in which the case is filed. This helps provide assurance to attorneys that courts will consider their home rate in fee applications.

<sup>57</sup>We asked each attorney and judge if he or she thought court administrative capacity was a factor in venue selection. While some attorneys and judges also offered convenience as a factor during our interviews, we did not specifically ask them about this factor.

<sup>58</sup>The methodologies used by the different studies include interviews, questionnaires, summaries of group discussions, and statistical analyses of case data.

<sup>59</sup>(1) Marcus Cole. "Delaware Is Not a State: Are We Witnessing Jurisdictional Competition in Bankruptcy?" *Vanderbilt Law Review*, November 2002; 55, 6 (Cole 2002). (2) Federal Judicial Center. *Conference on Large Chapter 11 Cases*. 2004 (FJC 2004). (3) Kenneth M. Ayotte and David A. Skeel, Jr. "Why Do Distressed Companies Choose Delaware? An Empirical Analysis of Venue Choice in Bankruptcy." *University of Pennsylvania, Institute for Law & Economic Research Paper No. 03-29*, October 2004 (Ayotte and Skeel 2004). (4) Lynn M. LoPucki and Joseph W. Doherty. *Courting Failure: How Competition for Big Cases Is Corrupting the Bankruptcy Courts*. Ann Arbor: University of Michigan Press, 2005 (LoPucki 2005).

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were located. The 2002 study also identified predictability and speed (how fast a case moves through the court) as the most prevalent factors, and lender preference as a less prevalent factor in venue selection.<sup>60</sup> One study from 2004 suggested that firms with secured lenders exhibited a strong preference for filing in Delaware.<sup>61</sup> Two studies from 2002 and 2004 cited attitudes towards fees as a factor in venue selection; however, one noted that fees were not the most prevalent factor.<sup>62</sup> In contrast to this finding and the results of our interviews, one study we reviewed identified the perceived scrutiny of professional fees as a key factor in venue selection.<sup>63</sup> In this study and in subsequent work, the author contends that attorneys chose to file in venues where they believed their fee requests would be approved and theorized that some courts may have relaxed their scrutiny of fees in order to attract more large cases.<sup>64</sup>

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<sup>60</sup>Cole 2002. This study identifies a total of 10 factors, listed in order of importance. Rankings are based on attorney interview responses about reasons they view Delaware as a superior venue. Three of the top four (1, 2 and 4) are referenced above. The full list of factors includes (1) predictability, (2) speed, (3) the absence of real law or legal precedent, (4) the sophistication and expertise of judges, (5) the responsiveness and availability of judges, (6) less scrutiny of attorney fee applications, (7) geographic convenience, (8) creditor pressure, (9) danger of a bad judge, and (10) the intrusiveness of the local UST. Cole's data collection methods include a combination of interviews, questionnaires, and informal conversations with more than 50 attorneys and judges.

<sup>61</sup>Ayotte and Skeel 2004. This study used statistical analyses of case data from all firms filing for Chapter 11 between 1990 and 2000 with at least \$50 million in reported assets. Analyses involving venue selection included only cases with companies incorporated in Delaware so that Delaware was an option in venue selection. This study also suggested that court characteristics are important factors in venue selection.

<sup>62</sup>Cole 2002; FJC 2004. The FJC study (2004) is a record of conversations among 30 judges and attorneys assembled at a conference.

<sup>63</sup>LoPucki 2005. LoPucki's 2005 book references interviews and data analyses conducted in prior studies.

<sup>64</sup>LoPucki 2005 and Lynn LoPucki and Joseph Doherty. *Professional Fees in Corporate Bankruptcies: Data, Analysis, and Evaluation*. New York: Oxford University Press, 2011 (LoPucki 2011).

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## Bankruptcy Attorneys, Judges, and Academic Research Identify Positive and Negative Effects of Venue Selection Outcomes

Bankruptcy attorneys and judges we interviewed and academic research we reviewed identified both positive and negative effects of the concentration of cases in the SDNY and Delaware. Of the 94 guidelines cases filed from November 2013 through March 2015, 64 percent (60 of 94) were filed in the SDNY or Delaware, with the majority filed in Delaware. Our analysis of data related to these cases found that in 5 of the 14 guidelines cases filed in the SDNY, and in all of the 46 guidelines cases filed in Delaware, the venue selected differed from the company's headquarters address. See appendix III for a more detailed analysis of the venue rules used as the basis for selecting the filing location in guidelines cases.

Thirty-two of the 39 attorneys and judges we spoke with cited at least one effect of the concentration of cases in the SDNY and Delaware, with 24 identifying positive effects and 29 identifying negative effects. The positive effect most commonly cited by attorneys (5 of 14) and judges (10 of 25) we interviewed was the significant large case experience developed by judges in the SDNY and Delaware. For example, 1 judge noted that the concentration of cases in the SDNY and Delaware has resulted in experienced judges with vetted, expedited procedures and processes.<sup>65</sup> Six stakeholders noted that the body of court rulings the SDNY and Delaware courts have developed is another positive effect. Of the 18 stakeholders who mentioned one of these two benefits of case concentration, 8 explained that as a result, the SDNY and Delaware courts offer a degree of certainty in terms of case outcomes that does not exist in other courts. For example, 1 attorney said that he always advises clients on potential case outcomes, and the precedents in the SDNY and Delaware allow him to provide more predictability for his clients.

Twenty-nine attorneys and judges identified negative effects of case concentration in the SDNY and Delaware, but they differed in their opinions of the most significant negative effects. The negative effects most commonly cited by attorneys (9 of 14) were the difficulty local bankruptcy firms face in maintaining a bankruptcy practice outside of the SDNY and Delaware and the lack of opportunity for courts to develop precedent and expertise outside of these jurisdictions.<sup>66</sup> For example, 1

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<sup>65</sup>Other attorneys and judges we interviewed said that, in their experience, there are experienced and capable judges in bankruptcy courts across the country—not just in the SDNY and Delaware.

<sup>66</sup>Four judges also cited the negative effect on local bankruptcy bars.

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attorney noted that firms in other parts of the country lose bankruptcy clients to SDNY and Delaware firms. The negative effect most commonly cited by judges (12 of 25) was the challenges small creditors face when a case is filed far from a company's headquarters location.<sup>67</sup> Four judges said that moving a case from the company's home jurisdiction can disenfranchise small businesses and individuals who may want to participate in a case but are unable to do so because of the expense of travelling to a court in another jurisdiction.<sup>68</sup> Additionally, 4 judges and 1 attorney said that the concentration of cases has a negative effect on the bankruptcy system as a whole. For example, 1 judge noted that when money is spent hiring local counsel and traveling to distant courts instead of filing where a company's assets and employees are located, people view the system as corrupt.

Similarly, the academic studies we reviewed identified both positive and negative effects of case concentration in the SDNY and Delaware. As one academic expert we spoke with noted, there is a divergence in the academic findings and opinions related to venue. For example, two empirical studies from 1997 and 2004 suggested that cases filed in Delaware moved through the bankruptcy system faster than those filed in other courts.<sup>69</sup> Other studies suggested that cases filed in the SDNY and Delaware had a higher refiling rate than cases filed in other courts and that cases filed in a venue outside the company's headquarters, such as the SDNY or Delaware, cost more than cases filed in home jurisdictions.<sup>70</sup> In contrast, one academic expert argued that some cases in Delaware did not have a higher refiling rate than other courts with a similar caseload, and more recent work by another academic suggests that cases in the

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<sup>67</sup>Four attorneys also commented on the negative effect of case concentration on small creditors. A creditor is someone to whom the debtor owes money, or who claims to be owed money by the debtor. Small creditors may include individual employees or small businesses affected by a company's bankruptcy.

<sup>68</sup>Judges in the SDNY said that their courts take steps to accommodate small creditors in a case. For example, the SDNY will simulcast hearings to local courts so local parties can view the proceedings without travel.

<sup>69</sup>Federal Judicial Center. *Chapter 11 Venue Choice by Large Public Companies: Report to the Judicial Conference Committee on the Administration of the Bankruptcy System. 1997* (FJC 1997), Ayotte and Skeel 2004.

<sup>70</sup>LoPucki 2005, 2011. Findings suggesting higher refiling rates were based on analysis of cases filed between 1983 and 2000.

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SDNY and Delaware do not cost more.<sup>71</sup> Additionally, a 2015 study found that having a case assigned to an experienced judge is a key factor in the success of a bankruptcy filing and that there is a high correlation between judge experience and jurisdiction, with highly experienced judges presiding over most SDNY and Delaware cases.<sup>72</sup> However, as one expert we interviewed noted, because fewer cases are filed in venues other than the SDNY and Delaware, it is difficult for judges outside of those districts to gain experience with large Chapter 11 cases.

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## Agency Comments

We provided a draft of this report to the Executive Office for U.S. Trustees (EOUST) and the Administrative Office of the U.S. Courts (AOUSC) on August 21, 2015, for review and comment. In its written comments, reproduced in appendix IV, the EOUST generally agreed with our findings. We also received technical comments from EOUST and AOUSC, which we incorporated as appropriate.

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We are sending copies of this report to the Senate Committee on the Judiciary, the Director of the Executive Office for U.S. Trustees, the Director of the Administrative Office of the U.S. Courts, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

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<sup>71</sup>Robert K. Rasmussen, "Empirically Bankrupt." *Colum. Bus. L. Rev.* 179 2007 (Rasmussen 2007). Stephen J. Lubben "Corporate Reorganization & Professional Fees." *The American Bankruptcy Law Journal* 82, no. 1 (Winter 2008, 2008): 77-139 (Lubben 2008); and "What we "Know" about Chapter 11 Cost is Wrong." *Fordham Journal of Corporate & Financial Law* 17, no. 1 (2012): 141-188 (Lubben 2012). Rasmussen's findings suggest that Delaware's refiling rate for traditional cases, which made up the majority of the cases during the time period studied, was similar to that of two other busy bankruptcy courts – SDNY and Central California. However, he noted that the refiling rate for prepackaged cases—where a company and creditors agree on a reorganization plan before filing—did appear to be higher.

<sup>72</sup>Lynn M. LoPucki and Joseph W. Doherty. "Bankruptcy Survival." 62 *UCLA L. Rev.* 970 (2015).

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If you or your staff have any questions about this report, please contact me at (202) 512-9627 or [maurerd@gao.gov](mailto:maurerd@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink that reads "David C. Maurer". The signature is written in a cursive style with a large, sweeping initial "D" and a long, horizontal flourish at the end.

David C. Maurer  
Director  
Homeland Security and Justice

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# Appendix I: Objectives, Scope, and Methodology

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This report addresses the following questions:

1. To what extent have bankruptcy attorneys observed the 2013 guidelines in fee applications, and what are the opinions of bankruptcy stakeholders, including attorneys, judges, and U.S. Trustee Program (USTP) officials, regarding the guidelines' key provisions and their effects?
2. What do bankruptcy attorneys, judges, and available research identify as factors that contribute to venue selection and the effects, if any, of venue selection in large Chapter 11 cases?

To obtain background information and answer both questions, we reviewed the Bankruptcy Code and relevant bankruptcy filings related to professional fees in Chapter 11 bankruptcy cases.<sup>1</sup> We also reviewed the 1996 USTP guidelines and the 2013 USTP guidelines on the compensation of attorneys in large Chapter 11 cases, or those with assets and liabilities each of \$50 million or more.<sup>2</sup> We analyzed USTP data related to Chapter 11 cases filed from October 2009 through March 2015 to identify the number of large cases filed during this time period in each USTP office. We selected this time period because it enabled us to identify case activity in the years both before and after the 2013 guidelines went into effect. According to USTP data, 765 cases with assets and liabilities each of \$50 million or more were filed from October 2009 through March 2015. Of these cases, 94 were filed after the 2013 guidelines went into effect (guidelines cases).<sup>3</sup> To assess the reliability of these data, we interviewed USTP officials responsible for collecting and reviewing the information and cross-checked the names of the guidelines

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<sup>1</sup>E.g., 11 U.S.C. § 330(a).

<sup>2</sup>28 C.F.R. pt. 58, App. A (Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. 330); Appendix B Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under United States Code by Attorneys in Larger Chapter 11 Cases, 78 Fed. Reg. 36248 (June 17, 2013).

<sup>3</sup>For those cases filed before the 2013 guidelines went into effect, the USTP identified relevant cases by the self-reported asset and liability amounts reported on a case's bankruptcy petition. As a result, for fiscal year 2010 through fiscal year 2012, the number of cases meeting the 2013 guidelines' asset and liability thresholds may be undercounted because jointly administered cases where none of the cases individually met the asset and liability thresholds would not necessarily have been captured in the search. Additionally, according to USTP officials, approximately 1 percent of the total cases did not contain either asset or liability information.

cases against lists of the 20 largest cases filed in 2014 as identified by the bankruptcy research website New Generations (BankruptcyData.com).<sup>4</sup> We determined that the data were sufficiently reliable for our purposes. As discussed in detail later in this appendix, we used the case information to inform our selection of a nongeneralizable sample of bankruptcy stakeholders for semistructured interviews. While the views expressed in these interviews do not represent those of all bankruptcy stakeholders, they provide valuable insights from stakeholders who have experience with large Chapter 11 bankruptcy cases and the 2013 USTP guidelines. We also conducted interviews with Executive Office for U.S. Trustees (EOUST) officials, U.S. Trustees (UST), academics, and industry stakeholders.<sup>5</sup> Finally, we reviewed relevant academic literature on professional fees and venue selection in Chapter 11 bankruptcy cases. Because fee reduction is not a stated goal of the 2013 guidelines, we did not attempt to determine whether or not the guidelines have led to an actual reduction in professional fees awarded in large Chapter 11 cases.

To further address question 1, we reviewed data from the USTP's Significant Accomplishments Reporting System (SARS) on objection and inquiry activities related to professional fees in guidelines cases filed from November 2013 through March 2015. We analyzed the objections and inquiry data, including narrative descriptions, to identify USTP actions related to the 2013 guidelines provisions. To assess the reliability of these data, we interviewed officials responsible for entering and maintaining the data and reviewed internal documentation and guidance associated with data entry and internal review processes. We determined that the data were sufficiently reliable for our purposes. We also reviewed information collected by the EOUST on whether the provisions of the 2013 guidelines were observed in cases filed from November 2013 through March 2015 to determine the extent to which attorneys filing fee applications included information related to the 2013 guidelines' provisions. To determine whether selected local court rules incorporated the key provisions of the 2013 guidelines, we reviewed local court rules and guidelines on fee

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<sup>4</sup>This site was identified by bankruptcy experts as a reliable source of information on large bankruptcy cases.

<sup>5</sup>We identified relevant academics and industry stakeholders through referrals from agency officials and a literature search on professional fees and venue selection in Chapter 11 bankruptcy cases.

applications and the compensation of professionals in bankruptcy cases for the 15 bankruptcy courts in our scope. These courts were selected because they had 5 or more large Chapter 11 cases filed from fiscal year 2010 through fiscal year 2014. Additional information regarding the jurisdictions in the scope of this report is provided later in this appendix.

To further address question 2, we reviewed relevant academic literature on the factors that contribute to venue selection and the effects of the concentration of cases in the Southern District of New York (SDNY) and the District of Delaware (Delaware). We also interviewed six academic experts in the Chapter 11 bankruptcy field to better understand their research findings. We conducted a literature search of various databases, such as ProQuest and Academic OneFile, and asked the academic experts we interviewed to recommend additional studies. From these sources, we identified 10 studies published between 1997 and 2015 that were relevant to our question on venue selection. We reviewed the methodologies of these studies to ensure they were sound and determined they were sufficiently reliable to identify factors related to venue selection and the effects of case concentration. To identify the basis for venue selection companies used when filing cases, we reviewed bankruptcy filing documents for each of the 94 guidelines cases filed from November 2013 through March 2015.<sup>6</sup> We also reviewed the first day declarations for these cases to identify each company's place of incorporation and headquarters location. In cases where we were not able to identify this information, we reviewed Securities and Exchange Commission filings or filings with state secretary of state offices, as necessary.

#### **Semistructured Interviews:**

To obtain perspectives from bankruptcy stakeholders on the 2013 guidelines and issues related to venue selection, we conducted 57 semistructured interviews with a nongeneralizable sample of 18 Assistant U.S. Trustees (AUST), 25 U.S. Bankruptcy Court judges, and bankruptcy

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<sup>6</sup>Companies disclose the basis for their venue choice by checking one or more of three boxes listed on the filing petition. The first box covers domicile, which includes place of incorporation and principal place of residence or assets. The second box is checked if the company has an affiliate or partner that has filed for bankruptcy in the jurisdiction. Finally, the third box involves foreign proceedings.

attorneys from 14 law firms. Our process for selecting each group of stakeholders in our sample is discussed below:

**AUSTs:** We chose to interview AUSTs because they are responsible for the day-to-day oversight of federal bankruptcy cases and for reviewing fee applications. There are 21 UST regions with 93 field offices. Each field office is managed by an AUST. To determine the scope from which to select our sample of AUSTs for interviews, we reviewed USTP data on large Chapter 11 cases (cases with assets and liabilities each of \$50 million or more) filed from fiscal year 2010 through fiscal year 2014. From this, we identified 18 USTP offices that had a total of five or more large cases during this time period. Of these offices, 12 offices had been assigned a guidelines case as of October 2014, while 6 offices had not.<sup>7</sup> We interviewed 18 AUSTs assigned to each of the 18 offices (see table 2). At the time our interviews were conducted, 13 of the 18 AUSTs had participated in at least one guidelines case.

**Judges:** Bankruptcy judges have the final authority to award professional fees and to determine whether or not they are reasonable and necessary, under the Bankruptcy Code.<sup>8</sup> To select our sample of bankruptcy judges to interview, we relied on the same selection criteria we used to select AUSTs. We matched each UST office/city with 5 or more large Chapter 11 cases from fiscal year 2010 through fiscal year 2014 to the corresponding judicial district for the U.S. Bankruptcy Courts. We identified 15 judicial districts covering the 18 cities in our AUST sample.<sup>9</sup> To select individual judges for our interviews, we contacted the Chief Judge of each of the 15 bankruptcy courts and asked him or her to identify judges in those courts with experience in our topic areas who were available to be interviewed. To ensure that we spoke with judges with a range of experience in guidelines cases, we initially selected two judges in the each of the courts with 15 or more large Chapter 11 cases

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<sup>7</sup>One office in our sample was assigned a guidelines case in January 2015. Therefore, by the time we conducted our interviews, 13 USTP offices and their corresponding AUSTs had participated in at least one guidelines case.

<sup>8</sup>11 U.S.C. § 330(a).

<sup>9</sup>There are a total of 90 U.S. Bankruptcy Courts and 369 bankruptcy judges, including 328 active and 41 recalled judges.

and one judge in each of the remaining courts (see table 2).<sup>10</sup> We interviewed a total of 25 judges. Of these, 11 judges presided over one or more cases subject to the guidelines, while 14 judges had not yet been involved with a guidelines case. With the exception of one judge who had been appointed to the bench in 2013, all judges interviewed had presided over at least one case between October 2009 and October 2013 that met the guidelines thresholds of assets and liabilities each of \$50 million or more.

**Table 2: U.S. Trustee Program Offices, U.S. Bankruptcy Court Judicial Districts, and Associated Large Chapter 11 Cases with Number of Assistant U.S. Trustees and Number of Judges Included in Interview Sample**

	U.S. Trustee Office	U.S. Bankruptcy Court judicial district	Number of large Chapter 11 cases fiscal years 2010-2014	Number of Assistant U.S. Trustees interviewed	Number of judges interviewed
1.	New York	Southern District of New York	273	1	3
2.	Wilmington	Delaware	177	1	2
3.	Dallas	Texas Northern	36	1	2
4.	Santa Ana	California Central	18	1	2
5.	Los Angeles	California Central	10	1	1
6.	Newark	New Jersey	16	1	2
7.	Phoenix	Arizona	15	1	1
8.	Chicago	Illinois Northern	15	1	2
9.	Las Vegas	Nevada	12	1	1
10.	Reno	Nevada	5	1	1
11.	Miami	Florida Southern	10	1	1
12.	Seattle	Washington Western	9	1	1
13.	Houston	Texas Southern	9	1	1
14.	Tampa	Florida Middle	7	1	1
15.	Orlando	Florida Middle	5	1	1
16.	Boston	Massachusetts	6	1	1

<sup>10</sup>While we initially requested interviews with two judges in the Southern District of New York, three judges responded. Additionally, we interviewed one judge in Phoenix. We also interviewed two judges from districts outside of the scope of our review as part of our background research. Their responses were not included in our final results.

	U.S. Trustee Office	U.S. Bankruptcy Court judicial district	Number of large Chapter 11 cases fiscal years 2010-2014	Number of Assistant U.S. Trustees interviewed	Number of judges interviewed
17.	Atlanta	Georgia Northern	5	1	1
18.	Richmond	Virginia Eastern	6	1	1
<b>Total</b>			<b>634</b>	<b>18</b>	<b>25</b>

Source: GAO analysis and U.S. Trustee Program data. | GAO 15-839

Bankruptcy attorneys: To select attorneys to interview, we reviewed the guidelines case data provided by the USTP for all cases subject to the 2013 guidelines in fiscal year 2014. We identified selected guidelines cases filed in bankruptcy courts in 12 of the 18 cities listed in table 2 and reviewed the related bankruptcy filing petitions to identify law firms that represented the debtor in these cases. We selected cases to provide variation in geographic location and in case size. To ensure that we included attorneys from firms with substantial experience with large Chapter 11 cases, we cross-checked the list of firms with those identified as the top bankruptcy firms in the United States by two bankruptcy research websites, the University of California Los Angeles' (UCLA-LoPucki) Bankruptcy Research Database and New Generations (BankruptcyData.com).<sup>11</sup> Firms were not excluded if they did not appear on these lists, but we added several major firms that did not appear on our original list. See table 3 for a list of the 14 firms from which we interviewed attorneys. Each of the firms represented companies in at least one 2013 guidelines case.<sup>12</sup> In 4 of the 14 interviews we conducted, more than one attorney participated in the interview. However, because the opinions offered by attorneys in each of these individual interviews did not conflict or contradict one another, we counted each interview as one and refer to this group of stakeholders as 14 attorneys throughout this report.

<sup>11</sup>These sites were recommended to us by bankruptcy experts as reliable sources of information on large bankruptcy cases.

<sup>12</sup>Although we selected firms based on their role as debtor's counsel in at least one 2013 guidelines case, many firms also had experience representing debtors, creditors, or others in large Chapter 11 cases.

**Table 3: Law Firms from Which Attorneys Were Selected for Interviews**

	Law firm
1	Akin, Gump, Strauss, Hauer & Feld
2	Dechert
3	DLA Piper
4	Gordon Silver
5	Hunton & Williams
6	K&L Gates
7	Kirkland & Ellis
8	Latham Watkins
9	Nixon Peabody
10	Norton Rose Fulbright
11	Squire Patton Boggs
12	Proskauer Rose
13	Skadden, Arps, Slate, Meagher & Flom
14	Stroock & Stroock & Lavan

Source: GAO. | GAO 15-839

We asked all three groups about their general opinions of the 2013 guidelines and their opinions regarding the effects or potential effects, if any, of the 2013 guidelines on efficiency, transparency, or the professional fees awarded in Chapter 11 cases. We focused on these three aspects because two of the goals of the 2013 guidelines are to increase the transparency and efficiency of the fee review process, and, as discussed earlier in this report, EOUST officials reported that concerns about professional fees in large cases such as Lehman Brothers provided the impetus for developing the new guidelines. While we did ask stakeholders to identify any provisions they believed were likely to have an effect or to have no effect, we did not specifically ask stakeholders about their opinions on each provision of the 2013 guidelines.<sup>13</sup> We also asked all three groups about the extent to which the provisions of the guidelines were observed by attorneys in fee applications submitted for guidelines cases.

<sup>13</sup>Not all stakeholders commented on the guidelines' effect on the three specific aspects we identified, and not all stakeholders commented on each provision of the guidelines.

In addition, we asked judges and attorneys their opinions on the factors that contribute to venue selection and the effects, if any, of the concentration of cases in the SDNY and Delaware. Because the AUSTs do not have a role in venue selection, we did not ask them questions related to venue selection. We asked attorneys and judges for their opinion on specific venue selection factors. For example, we asked attorneys and judges about the degree to which the following factors contribute to venue selection: (1) judge experience, (2) court administrative capacity, (3) prior court rulings, and (4) perceptions of court attitudes on professional fees. Because of the semistructured nature of the interviews, stakeholders responded to these factors and also independently offered additional factors. Additionally, responses may total more than 100 percent because stakeholders offered both positive and negative opinions in response to certain questions. The semistructured interviews were conducted by telephone from February 2015 through May 2015. We then performed a qualitative content analysis of these interviews to identify common themes and the frequency with which certain issues were raised. To ensure intercoder reliability, three analysts jointly developed a coding structure that was then used to independently code the interviews. This process was reviewed by a GAO methodologist, and all coding was reviewed by another analyst. Any discrepancies were discussed and resolved jointly by the analysts responsible for coding the interviews.

We conducted this performance audit from November 2014 to September 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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# Appendix II: Executive Office for U.S. Trustees 2013 Fee Guidelines for Attorneys in Larger Chapter 11 Cases: Summary of Material Differences From 1996 Guidelines

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The following items represent provisions of the U.S. Trustee Program's (USTP) 2013 fee guidelines that were not included in the USTP's 1996 fee guidelines. Each entry refers to a particular provision of the 2013 guidelines, and includes a brief description of the provision's primary purpose or criteria.

## **1. Customary and Comparable Compensation Disclosures**

- Disclose firm's nonbankruptcy blended hourly rates by category of timekeeper
- Limited "safe harbor" from USTP objection

## **2. Budgets and Staffing Plans**

- By consent or court order
- Hours and fees per task code; no narrative or description
- Disclosed with fee application
- If fee application exceeds budget by 10 percent, explain why

## **3. Electronic Billing Data**

- Provide billing data as maintained by firm to court, USTP, and major parties; other parties on request
- Virtually all firms and clients use LEDES (legal electronic data exchange standard) data (LEDES.org)

## **4. Client and Applicant Statements**

- Applicant with retention application
- Client with retention application (verified)
- Applicant with fee application

## **5. Rate Increase Disclosures and Calculations**

- Questions on disclosure and approval of rate increases in applicant statement (4 above)
- Disclose initial rate and current rate for each timekeeper
- Disclose number of rate increases since case inception for each timekeeper
- Calculate total compensation requested with and without rate increases

**6. Efficiency Co-Counsel Retention and Billing Guidance**

- Encouraged for routine work at lower cost
- Compare billing rates and terms with lead counsel; demonstrate projected savings to estate
- Avoid duplication

**7. Fee Examiner and Fee Committee Models**

- Three models
  1. Fee examiner (not § 1104)
  2. Fee committee with independent chair
  3. Fee committee
- Experienced bankruptcy professional
  1. Not a prohibited special master; court must still adjudicate issues and award fees
  2. More than fee auditor focused solely on numbers

**8. Five Model Forms (Portable Document Format [PDF]) fillable model forms will be available on USTP website)**

- Exhibit A: Customary and Comparable Compensation Disclosures
- Exhibit B: Summary of Timekeepers Included in this Application
- Exhibit C: Budget and Staffing Plan
- Exhibit D: Summary of Compensation by Project Category
- Exhibit E: Summary Cover Sheet of Fee Application

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# Appendix III: Basis for Venue Selection in Cases Subject to the U.S. Trustee Program's 2013 Guidelines

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From November 2013 through March 2015, 94 Chapter 11 bankruptcy cases met the U.S. Trustee Program's 2013 guidelines' thresholds of assets and liabilities each of \$50 million or more (guidelines cases). A company may choose the court, or venue, in which to file its case on the basis of where the company is domiciled, which has been interpreted as the company's place of incorporation, or where it maintains its residence or principal place of business (headquarters) or assets.<sup>1</sup> For example, one guidelines case involves a telecommunications holding company that is headquartered in Virginia and maintains its principal assets in three New York financial institutions. A company may also file in a court where an affiliate, such as a franchise or dealership related to the parent company, has already a Chapter 11 bankruptcy case pending (known as the affiliate filing rule). We reviewed 91 of the 94 guidelines cases and found that 63 percent (57 of 91) were filed in a venue that differed from their headquarters location (see table 4 below).<sup>2</sup> To identify the provisions companies used as the basis for selecting the venue in which to file their case, we reviewed the initial bankruptcy filing petitions for each of the 91 cases included in our analysis.<sup>3</sup> We also reviewed first day declarations, and, as necessary, filings with the Securities and Exchange Commission or state secretary of state offices to identify the place of incorporation and headquarters location for each guidelines case.

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<sup>1</sup>*In re Segno Communications, Inc.*, 264 B.R. 501, 506 (Bankr. N.D. Ill. 2001).

<sup>2</sup>The remaining 3 cases were filed by individuals and were excluded from our analysis because individuals generally may not avail themselves of the same choices in venue as are available to companies.

<sup>3</sup>Companies disclose the basis for their venue choice by checking one or more of three boxes listed on the filing petition. A company checks the first box if its venue choice is based on domicile, residence, principal place of business, or principal place of assets. A company may be domiciled in its place of incorporation. The second box is checked if the company has an affiliate or partner that has filed for bankruptcy in the jurisdiction. Finally, the third box involves foreign proceedings.

Appendix III: Basis for Venue Selection in Cases Subject to the U.S. Trustee Program's 2013 Guidelines

**Table 4: Guidelines Cases Filed by Companies Both within and outside Company Headquarters Location**

<b>Bankruptcy Court filing location</b>	<b>Number of guidelines cases filed by companies November 2013 - March 2015</b>	<b>Cases with headquarters address in filing location</b>	<b>Cases with headquarters address outside filing location</b>
Central District of California	1	1	0
District of Arizona	1	1	0
District of Delaware	46	0	46
District of Massachusetts	1	1	0
District of Nevada	1	0	1
District of New Hampshire	1	1	0
District of New Jersey	3	2	1
District of Oregon	1	1	0
District of Utah	1	0	1
Eastern District of Kentucky	1	1	0
Eastern District of Virginia	2	2	0
Middle District of Florida	1	1	0
Northern District of Illinois	3	2	1
Northern District of Texas	2	2	0
Southern District of Florida	1	1	0
Southern District of Mississippi	2	2	0
Southern District of New York	14	9	5
Southern District of Texas	6	5	1
Western District of Michigan	1	1	0
Western District of Oklahoma	1	1	0
Western District of Texas	1	0	1
<b>Total</b>	<b>91</b>	<b>34</b>	<b>57</b>
		37%	63%

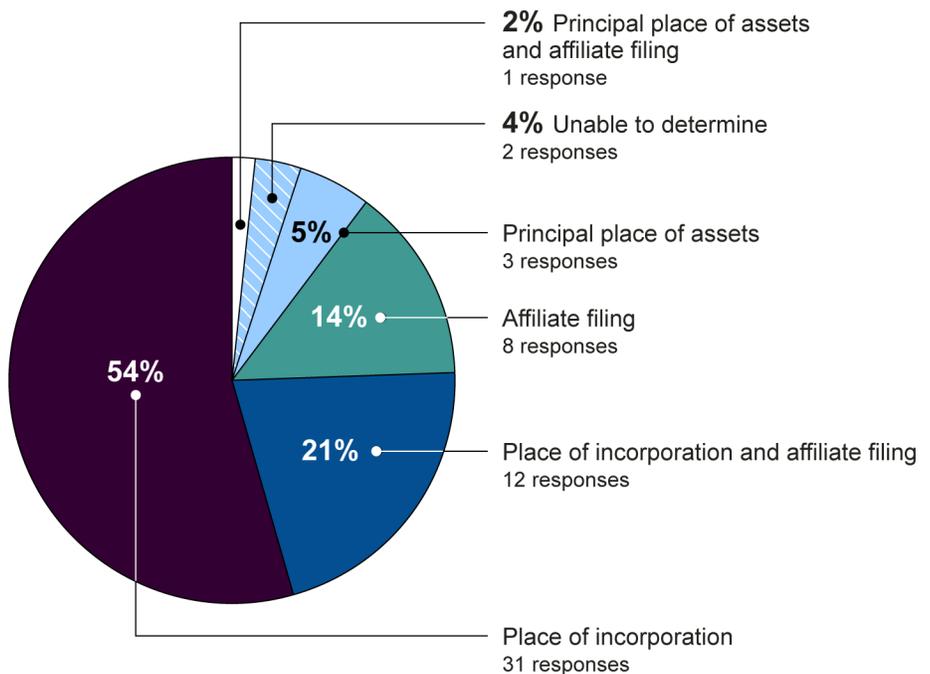
Source: GAO analysis of 2013 guidelines cases. | GAO 15-839

Note: Chapter 11 cases filed by individuals were excluded from this analysis because individuals generally may not avail themselves of the same choices in venue as are available to companies.

As shown in table 4, 57 of the 91 cases that were filed by companies through March 2015 filed in venues outside the company's stated headquarters location. Of the options available to them under the

Bankruptcy Code, companies in 31 of the 57 cases relied on place of incorporation as the primary basis to select their filing location (see fig. 6). All but 2 of these cases were filed in Delaware.<sup>4</sup> Additionally, 8 relied on the affiliate filing rule, and 3 used principal place of assets as the basis for venue selection.<sup>5</sup> In 12 cases filed outside of the headquarters location, data provided by the companies indicated that both place of incorporation and the affiliate filing rule were the bases for venue selection.

**Figure 6: Basis for Venue Selection for Companies Filing Cases outside their Headquarters Location**



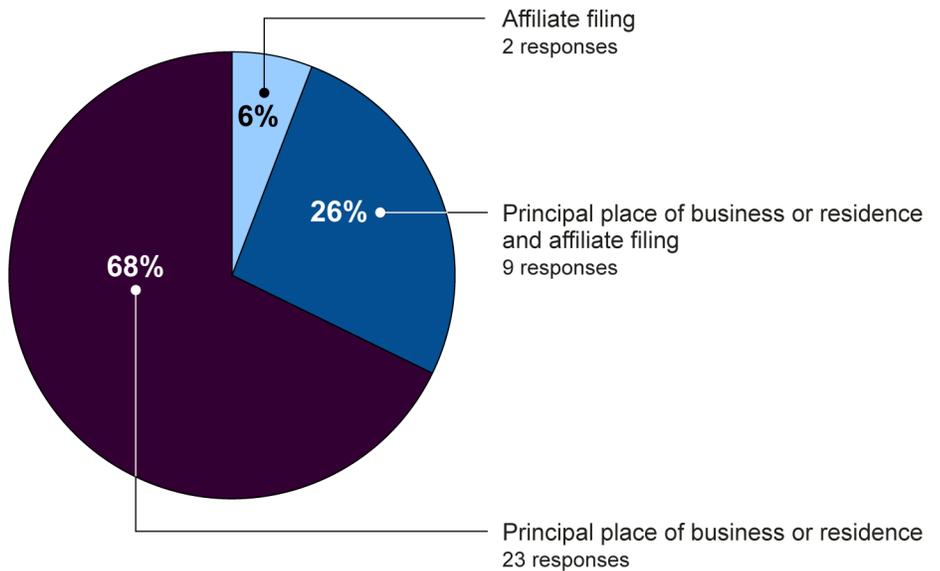
Source: GAO. | GAO-15-839

<sup>4</sup>In 2 cases, a company filed for Chapter 11 bankruptcy in the state in which its headquarters was located, but in a different jurisdiction within that state. For example, a company headquartered in Saratoga County, New York, which is located in the Northern District of New York, filed for Chapter 11 bankruptcy in the SDNY.

<sup>5</sup>Data indicate that in 1 case, both principal place of assets and affiliate filing were used as the bases for selecting a venue outside of the company's headquarters location. We were unable to determine the basis for venue selection in 2 cases in which companies filed outside of their headquarters location.

As shown in table 4, 34 of the 91 guidelines cases filed by companies through March 2014 filed in the same venue as their stated headquarters location. Our analysis, as shown in figure 7, found that companies in 23 of the 34 cases relied on principal place of business or residence, and another 9 relied on both principal place of business or residence and the affiliate filing rule as the reason for selecting their headquarters venue.<sup>6</sup>

**Figure 7: Basis for Venue Selection for Companies Filing Cases within their Headquarters Location**



Source: GAO. | GAO-15-839

<sup>6</sup>Two companies that filed for bankruptcy in courts within their headquarters location marked only the affiliate filing provision on the bankruptcy petition as their basis for venue selection. However, a review of the first day declarations for the companies found that, in both cases, the headquarters location was also within the filing venue.

# Appendix IV: Comments from the Department of Justice



U.S. Department of Justice

Executive Office for United States Trustees

Office of the Director

Washington, DC 20530

September 3, 2015

Mr. David C. Maurer  
Director, Homeland Security and Justice  
Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Maurer:

The United States Trustee Program (“USTP”) appreciates the insights and observations provided by the GAO’s study of the USTP’s development and implementation of “Guidelines for Reviewing Applications for Compensation filed by Attorneys in Larger Chapter 11 Cases” (“LCFG” or “Guidelines”).<sup>1/</sup> The GAO report is a valuable resource for the bankruptcy community in understanding the impact of the Guidelines on the fee review process.

The GAO correctly notes that the USTP’s goal in promulgating the Guidelines was to enhance transparency in the bankruptcy billing process and to ensure that bankruptcy fees do not exceed market rates. The GAO also correctly acknowledges that the recency of the promulgation of the LCFG and their application to fewer than 100 cases reviewed in the report makes definitive conclusions both difficult and premature. The GAO does not make any recommendations for the USTP to improve the Guidelines or their implementation, but we will carefully consider the GAO’s and stakeholders’ observations as the USTP continues its outreach to the bankruptcy community and refines its enforcement strategies.

The USTP takes this opportunity to provide some general observations on the report.

1. Initial opposition to the Guidelines by bankruptcy attorneys appears to be yielding to compliance and improved billing practices.

The report demonstrates that there has been substantial compliance with the Guidelines. Although more enforcement actions may have been expected during the initial phases of implementation, attorneys in approximately one-half of the early cases largely complied without any enforcement action by the USTP. This may be attributable to the USTP’s active engagement of the public, including professionals, in the multi-year development process; its significant outreach and training upon adoption; and its adherence to the stated goal of litigating only when

<sup>1/</sup> The Report also addressed venue selection for large chapter 11 cases. Although 18 of 25 judges interviewed by the GAO stated that professional fees are a factor in venue selection, the USTP’s role in policing venue selection is generally more limited to addressing violation of the venue statute and abuse of the process. See, e.g., *In re Houghton Mifflin Harcourt Pub. Co.*, 474 B.R. 122 (Bankr. S.D.N.Y. 2012) (debtor corporation misrepresented assets held in jurisdiction) and *In re Patriot Coal Corp.*, 482 B.R. 718 (Bankr. S.D.N.Y. 2012) (debtor corporation manufactured venue by creating an affiliate in the desired venue on the eve of bankruptcy).

necessary after consensual resolution was unreachable. It is important to note that, of the 98 formal or informal enforcement actions the Program was compelled to take, 92 were consensually resolved.

Retention and fee applications filed under the Guidelines also demonstrate improvement in billing practices and make it easier to ascertain whether the practices conform to statutory standards. For example, initial applications filed under the Guidelines have shown that some firms were charging rates to the debtor client that were higher than the rates charged to the same client prior to the bankruptcy case. Law firms would not have disclosed these rate increases in retention applications in cases filed before the LCFG went into effect. This suggests not only that the Guidelines help uncover instances in which billing practices violate statutory standards, but also that the additional disclosures may have a deterrent effect and cause changes to billing practices before the retention or fee applications are filed.

Although we have been able to avoid extensive litigation thus far, adoption of the LCFG through case law, local rules, or administrative orders promotes uniformity and consistency across judicial districts. The Guidelines do not have the force of law. As the GAO report shows, the result is that professionals and USTP personnel spend significant time and effort negotiating compliance on a case-by-case basis. Adoption of the Guidelines would preserve resources for all stakeholders by setting expectations more universally. Currently, 15 districts require compliance with the LCFG in their local rules and administrative orders.

2. The USTP should continue its outreach to explain the Guidelines to the bankruptcy community.

Some in the bankruptcy community continue to misunderstand certain aspects of the LCFG, particularly those relating to comparability data and other disclosures. As the GAO correctly notes in its report, current bankruptcy law already requires that professionals who wish to be paid from a bankruptcy estate provide evidence to support a finding that the compensation “is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than [bankruptcy cases].” 11 U.S.C. § 330(a)(3)(F). This statutory standard prohibits premiums above non-bankruptcy market rates and encourages billing discipline, including discounts and other legal cost control measures that prevail outside bankruptcy.

The LCFG simply provide the framework for practitioners to satisfy this requirement of the Bankruptcy Code. Though some contend that rates charged in bankruptcy cases are already comparable to non-bankruptcy rates, courts previously have had to make comparability findings based solely on an applicant’s conclusory affidavit or declaration. Under the LCFG, applicants now must provide evidence to support their statements. This provides greater assurance to the court, the USTP, and other parties that bankruptcy lawyers are subject to the same market discipline and practices as attorneys outside of bankruptcy. The argument made by some that comparing bankruptcy and non-bankruptcy rates is like “comparing apples to oranges” is at odds with the intent of Congress.

3. The LCFG address matters relating to professional compensation and cannot be expanded to address other legitimate concerns parties may have with the chapter 11 process.

Some of the comments made by practitioners and judges with respect to the LCFG go beyond the purpose of the Guidelines and reflect general frustration about the nature of the bankruptcy process and the high cost of chapter 11 case administration. For example, one judge criticized the Guidelines for not addressing the problem of high fees when chapter 11 cases go “off the rails” or experience unexpected setbacks that cause delays or unsuccessful results for creditors. Similarly, one attorney cited the Guidelines for failing to control professional costs that result from the length of time it takes to complete a case.<sup>2/</sup> Although these are valid concerns about bankruptcy practices, the Guidelines cannot address matters beyond professional compensation. We believe, however, that the Guidelines do help the courts and parties improve case administration by, among other things, encouraging budgets throughout the case and requiring more complete disclosure of the reasonableness of the tasks performed by attorneys.

In conclusion, the USTP looks forward to continuing to improve the process for the award of professional compensation in bankruptcy. Such improvement is important for the bankruptcy system—and for the millions of creditors in bankruptcy whose economic recoveries are affected by every dollar paid in professional compensation and the public who are concerned about the integrity and efficiency of the bankruptcy fee approval system. The USTP strongly believes the LCFG provide for meaningful disclosure and transparency and ensure that the fee review process is subject to client-driven market forces, accountability, and scrutiny as mandated by Congress in the Bankruptcy Code.

The USTP is grateful to the GAO for undertaking the Guidelines review and providing us with useful information that will assist us in performing our responsibilities as the “watchdog” of the bankruptcy system.

Sincerely,



Clifford J. White III  
Director

<sup>2/</sup> A major role of the USTP is to identify cases not making progress toward rehabilitation. The USTP files motions to convert to chapter 7 or dismiss a substantial portion of all chapter 11 cases filed.

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# Appendix V: GAO Contact and Staff Acknowledgments

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## GAO Contact

David C. Maurer, (202) 512-9627 or [maurerd@gao.gov](mailto:maurerd@gao.gov)

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## Staff Acknowledgments

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