

Rise of the Financial Advisors: An Empirical Study of the Division of Professional Fees in Large Bankruptcies

by

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and

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Many studies have sought to determine the total professional fees and expenses incurred in large, public company reorganizations.¹ With one recent exception, none of those studies has examined the division of professional fees by party represented or profession.² The study reported in this article was the first to do so.

The divisions are important because power follows the money.³ Creditors and equity holders sometimes participate in large, public company bankruptcies, either individually or in groups.⁴ They participate at a disadvantage, however, compared to groups whose participation is funded from the debtor's estate. Parties the estate subsidizes can afford to collect

*Security Pacific Bank Professor of Law, UCLA Law School. Address correspondence to lopucki@law.ucla.edu. This article is the third in a series reporting on an empirical study of professional fees in large bankruptcy reorganization cases. Elsewhere, we reported on the total amounts of fees and expenses awarded in large bankruptcy reorganization cases and the factors that determined those amounts. See Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL LEGAL STUD. 111, 115 (2004); Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases Revisited* (July 1, 2007) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=906184. We thank Frances Foster and Bob Rasmussen for comments on earlier drafts and Grant Newton for information on bankruptcy accounting practices. We thank Chris Wichrowski, Nathan Agam, Doug Flahut, Anil Kalia, Brett Kaplan, and Jean Sedlack for assistance with research.

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¹A list appears in Arturo Bris, Alan Schwartz, & Ivo Welch, *Who Should Pay for Bankruptcy Costs?*, 34 J. LEGAL STUD. 295, 296 n.1 (2005).

²After we completed the study reported in this article, the American Bankruptcy Institute released a study by Professor Stephen Lubben. That study, which reports data on some aspects of professional fee division, is published in this issue. Stephen J. Lubben, *Corporate Reorganization & Professional Fees*, 82, Am. Bankr. L.J. (2008).

³See discussion *infra* at note 12.

⁴They sometimes do so as "ad hoc" or "unofficial" committees.

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more information, purchase more and better advice, and litigate more issues more thoroughly.

We found that more than 80% of court-awarded fees and expenses⁵ were paid for representation of, or advice to, the debtor-in-possession (DIP). Nearly all of the remaining fees, about 19%, were paid for representation of, or advice to, unsecured creditors. The remaining 1% was divided among professionals representing or advising shareholders and court-appointed neutral professionals. Thus, the debtors' managers - who have the exclusive right to control the DIP's professionals - have considerably greater power than the unsecured creditors or shareholders.

The division of fee and expense awards among the professions is also important because it reflects the nature of the reorganization process. The fees awarded to financial advisors have been rising much faster than the fees awarded to attorneys, and the change seems to have been going on for a long time. Financial advisors - principally investment banks and turnaround managers - were bit players in the large public company bankruptcies of the 1980s. During the period this study covers - plans confirmed in 1998 through 2003 - attorneys still took the largest piece of the pie. Courts awarded 54% of fees and expenses to attorneys and 41% to financial advisors. Accountants received nearly all of the remaining 5%. But during this period, the fees of financial advisors grew at the rate of about 25% per year, whereas professional fees and expenses as a whole grew only about 9% per year.⁶ We conclude that since the 1980s, the nature of the restructuring process has changed. A greater proportion of professional efforts is now directed to the financial aspects of restructuring, a smaller proportion to the legal aspects.

Our findings are based on an examination of 931 fee and expense applications in seventy-four large public company⁷ reorganizations concluded by plan confirmation and the orders entered on the applications. The applications were made by lawyers, investment bankers, accountants, and other bankruptcy professionals. The orders awarded a total of \$1.6 billion in fees

⁵Fees and expenses include those awarded under 11 U.S.C. § 330 and exclude those awarded under 11 U.S.C. § 503(b)(3) and (4), except as otherwise indicated.

⁶Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases Revisited 4* (July 1, 2007) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=906184 [hereinafter *Determinants of Fees Revisited*].

⁷We have adopted the definition of "large public company" used by Lynn M. LoPucki in constructing the Bankruptcy Research Database. That database contains data on all large public company bankruptcies filed in the United States. A version of the database is available at <http://lopucki.law.ucla.edu>. A company is "large" if in its last 10-K filed with the Securities and Exchange Commission before bankruptcy it listed assets in excess of \$100 million, measured in 1980 dollars (approximately \$245 million in current dollars). A company is "public" if it filed an annual report with the Securities and Exchange Commission for a year ending in the last three years before bankruptcy. See Lynn M. LoPucki, *Protocols for the Bankruptcy Research Database* (2006) (on file with Lynn M. LoPucki), relevant portions available at http://lopucki.law.ucla.edu/contents_of_the_webbrd.htm.

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and expenses. The study included such well-known cases as Kmart, Global Crossing, US Airways, Polaroid, TWA, and Fruit of the Loom.⁸

Our methods of sample selection and data collection are discussed in two earlier articles.⁹

We presented a regression model that explained 85% of the variance in total professional fees and expenses based on three variables: company size, case duration, and the number of professionals sharing the fees. From the data in these seventy-four cases, we were able to estimate regression models of the determinants of the fees of (1) DIP bankruptcy attorneys, (2) DIP special counsel, (3) all attorneys, (4) DIP financial advisors, and (5) all financial advisors. The variables used in the fees and expenses model explained some of these subcategories of fees well but not others.

As with our earlier articles, we will post both our data and the statistical runs on the UCLA Law School Empirical Research Group web site.¹⁰ We post so that others can replicate the steps of our study or check the accuracy of our data and calculations. We include variable names in this article to facilitate that checking.

Part I describes how court-awarded fees and expenses are divided among professionals and their constituencies. Part II presents our regression models of the fees of attorneys, DIP bankruptcy attorneys, and DIP special counsel. It also discusses the significance of several associated findings. Part III presents regression models and discusses findings with respect to the fees of financial advisors generally and DIP financial advisors in particular. Part IV examines the determinants of the hourly rates the professionals charged. Part V concludes that by the end of the period our study covered, financial advisors probably were already receiving fees and expenses as high as those paid to attorneys, and that financial advisors' fees and expenses were continuing to increase.

I. THE DIVISION OF PROFESSIONAL FEES AND EXPENSES

Professional fees and expenses awarded in chapter 11 cases have priority as expenses of administration.¹¹ In the kinds of cases we studied, administra-

⁸Our data include hours and hourly rates for only the twenty-six most recently concluded cases in our sample.

⁹See Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL LEGAL STUD. 111, 115-16 (2004) [hereinafter *Determinants of Fees*]; *Determinants of Fees Revisited*, *supra* note 6, at 6-7.

¹⁰The web site is located at <http://www.law.ucla.edu/erg/pubs>.

¹¹11 U.S.C. § 503(b)(2). The fees and expenses analyzed in this article do not include fees and expenses awarded under 11 U.S.C. § 503(b)(3) and (4). The courts awarded only about \$7 million in fees under these provisions. We concluded that the pattern of these awards was sufficiently different that they should not be combined in the same analyses with fees and expenses awarded under 11 U.S.C. § 330(a).

tive priority makes payment in full virtually certain. In nearly all instances, the party seeking to retain the professional will file an application for authority to do so before, or shortly after, the commencement of representation and will obtain an order approving the terms of employment.

The ability to obtain representation and advice at the estate's expense confers substantial power on a party. The party will be in a position to determine and defend its interests in the bankruptcy case at no cost to itself. Among other advantages, representation increases the likelihood that the party (or the group it represents) will share in the distribution. A study of large, public company bankruptcy cases in the 1980s found that when an equity committee was appointed and permitted to retain counsel, the other parties to the case invariably offered equity a share of the distribution.¹² That occurred even when the shares were deeply underwater and general unsecured creditors recovered as little as five cents on the dollar.¹³

A. AMONG INVESTOR CONSTITUENCIES

To investigate how fee and expense awards allocated power among the different kinds of parties, we determined how the system allocated fee and expense awards among them. We found that 80% of awarded professional fees and expenses in the cases studied went to professionals working directly for the DIP.¹⁴ Standing alone, this figure suggests that DIPs - essentially the debtors' managers - exercise substantial control over the formulation of the business plan, the formulation of the plan of reorganization, and the progress of the case. This contrasts sharply with unsecured creditors, whose professionals were paid only 19% of the awarded fees and expenses, and with equity holders, whose professionals were paid only one-half of 1% of the awarded fees and expenses.

Court-awarded fees and expenses, however, do not tell the whole story. Debtors generally contract before bankruptcy to pay the fees and expenses of their secured creditors. These contracts are effective to the extent of the

¹²Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 159 (1991) ("Thus, in every case in which an equity committee was appointed, creditors at least offered equity holders a share in the distribution, regardless of how far 'underwater' the equity interests were.") [hereinafter *Bargaining over Equity's Share*].

¹³*Id.* at 142 (table showing unsecured creditor recoveries in cases where committees represented equity holders). The study did not report whether the equity committees retained professionals, but the practice at the time was such that probably all of the equity committees did retain at least one professional.

¹⁴The proportion awarded varied widely from case to case. In five cases, all of the fees and expenses awarded were for representation of the DIP. In two others, however, less than half of the fees and expenses awarded were for representation of the DIP. Professor Lubben reports a similar ratio. Lubben, *supra* note 2, at 33 ("In the big-case dataset . . . debtor professionals represent 79.9% of the total costs.")

value of the collateral.¹⁵ To the extent secured creditors recover fees and expenses from the value of the collateral, the effect is generally to reduce the value of the debtor's equity in the collateral and so generally to reduce the value of the estate. The economic effect is the same as if secured creditors received fee and expense awards. But secured creditors are not required to seek awards of their fees and expenses, and the amounts paid generally do not appear in the public record.

Although we have not been able to determine the amounts that secured creditors recover as fees and expenses, we have developed a method for estimating them and placing a limit on how high they might be. American Institute of Certified Public Accountants Statement of Position 90-7 governs the reporting of 10-K professional fees and expenses.¹⁶ It requires debtors that remain public companies to report their "expenses (including professional fees) . . . resulting from the reorganization and restructuring of the business . . . separately as reorganization items."¹⁷ The amounts reported are on average 59% higher than the professional fees and expenses and expenses awarded in the same cases.¹⁸

Because the two standards for reporting are so similar in other respects, the fees and expenses of secured creditors probably compose the bulk of that difference.¹⁹ Table 1, column (5) shows our estimate that 30% of fees and expenses go to secured creditors. That estimate is based on the assumption that secured creditors receive 80% of the amount by which 10-K professional fees and expenses exceed court-awarded fees and expenses, and that the remaining 20% is divided in the same proportions as court-awarded fees and

¹⁵11 U.S.C. § 506(b) provides:

To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

¹⁶See ACCOUNTING STANDARDS EXECUTIVE COMM., AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, STATEMENT OF POSITION 90-7: FINANCIAL REPORTING BY ENTITIES IN REORGANIZATION UNDER THE BANKRUPTCY CODE (1990), reprinted in 2 AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, AICPA TECHNICAL PRACTICE AIDS § 10,460 (1991).

¹⁷*Id.* at § 10,460.27.

¹⁸We previously reported this figure as 60%. See *Determinants of Fees Revisited*, *supra* note 6, at 34.

¹⁹After inquiring of financial advisors involved in some of the cases studied and other cases, Professor Grant Newton suggested these categories may account for the difference: (1) secured lenders' fees, (2) professionals involved in the debtors' transactions, (3) fees paid to claims agents, (4) auditing fees beyond the normal, non-restructuring auditing fees, (5) fees paid for services rendered after the final fee order, including avoidance actions, and (6) "ordinary course" fees paid under orders that waive filing of a fee application and entry of a subsequent order approving the specific amount to be paid. E-mail from Grant Newton, Professor of Accounting, Pepperdine University, to Lynn M. LoPucki, Security Pacific Bank Professor of Law, UCLA School of Law (Feb. 3, 2007, 10:28 PST) (on file with author).

expenses.²⁰

(1)	(2) Amount of court-awarded fees and expenses	(3) Percent of court-awarded fees and expenses	(4) Estimated amount of 10-K fees and expenses	(5) Estimated percent of 10-K fees and expenses
Debtor-in-possession	\$1,318,478,490	80.2%	\$1,472,670,146	56.5%
Unsecured creditors	\$303,882,170	18.5%	\$339,420,175	13.0%
Shareholders	\$8,331,779	0.5%	\$9,306,153	0.4%
Court-appointed neutrals	\$14,204,449	0.9%	\$15,865,612	0.6%
Secured creditors			\$769,460,788	29.5%
Total	\$1,644,896,888	100%	\$2,606,722,873	100%

Amounts in column (2) exclude those payable under 11 U.S.C. § 503(b)(3) and (4). Form 10-K fees and expenses are estimated at 1.584733 multiplied by the amounts in column (2). That ratio is the ratio of total 10-K fees and expenses to total court awarded fees and expenses in the twenty-four cases in which data were available. Secured creditors' fees and expenses are estimated at 80% of the excess of actual and estimated 10-K fees and expenses over court-awarded fees and expenses. Unsecured creditors' fees and expenses include \$20,763 awarded for representation of individual creditors. Debtor-in-possession fees and expenses include \$750,000 awarded for representation of directors.

The penny-pinching treatment of equity in these cases is a sharp change from the 1980s. LoPucki and Whitford found that equity committees were appointed in twenty-two of forty-three large, public company bankruptcies in the early 1980s (51%).²¹ By contrast, we found that the courts awarded fees and expenses for the representation of equity in only three of seventy-four cases (4%). Of the \$1.6 billion in fees and expenses awarded for representation in these seventy-four cases, only one-half of 1% (\$8.3 million) was spent for the representation of equity. LoPucki and Whitford argued that equity committees should not be appointed in cases where the debtor was clearly insolvent.²² But in thirty-two of the seventy-four cases we studied (43%), the debtor filed a petition showing its assets to exceed its liabilities according

²⁰The court-awarded fees and expenses reported in this and other studies include fees and expenses through the "final fee applications" filed shortly after confirmation of the plan. DIPs, creditors' committees, equity committees, and court-appointed neutrals may, however, incur fees and expenses after that cutoff. In addition, DIP professionals may earn fees and expenses before the bankruptcy that the DIP reports as professional fees and expenses for accounting purposes but which the professionals do not report to the court.

²¹*Bargaining over Equity's Share*, *supra* note 12, at 139 (listing cases).

²²Lynn M. LoPucki & William C. Whitford, *Preemptive Cram Down*, 65 AM. BANKR. L. J. 625, 625 (1991) ("The purpose of [the orders we propose] would be to prevent shareholders who have no plausible claim to share in the distribution under the absolute priority rule from disrupting the reorganization process in the hopes of obtaining a share through negotiations.").

to the "latest available information."²³ The courts awarded fees and expenses to equity committee professionals in only three of those thirty-two cases (9%).

The use of court representatives and neutrals in the administration of bankruptcy cases has been a frequent topic of discussion in recent years.²⁴ Given that attention, the professional fees and expenses paid to court representatives and neutrals seem surprisingly small. Court representatives and neutrals received only about \$14 million of the \$1.6 billion of fees and expenses awarded in the seventy-four cases studied (0.8%). The bankruptcy courts remain strongly committed to adversarial representation and advice in large, public company bankruptcies.

Table 2 shows the professional fees and expenses awarded to court representatives or neutrals in the seventy-four cases. Awards were made in only ten (14%). Eight of the ten (80%) were in courts other than Delaware and New York.²⁵ The difference between the proportion of Delaware and New York cases with fees and expenses paid to court representatives, two of forty-five cases (4%), and the proportion of cases from other courts with such fees and expenses paid, eight of twenty-nine (28%), was significant at the .04 level. Other courts were more likely than the Delaware and New York courts to award fees and expenses to court representatives or neutrals. At the same time, the amounts paid to neutrals in Delaware and New York far exceeded the amounts paid to neutrals in other courts.

Another way to view the division of fees and expenses - and hence of power - between DIPs and creditors' committees is to compare the amounts paid to their lead attorneys and financial advisors. In this calculation, the lead attorneys are the attorneys (1) not designated as "local" or "special," (2) who represented the DIP or the creditors' committee, and (3) who was, in our judgement, lead counsel (in all instances but one, this was the attorney who charged the largest total amount of fees and expenses to that party). Table 3 shows the results.

A comparison of the fees and expenses paid for lead representation and

²³That is the standard by which debtors are required to report the asset and liability data we used. See Fed. R. Bankr. P., Form 1, Ex. A.

²⁴See, e.g., *In re Federal Mogul-Global, Inc.* (Comm. of Equity Sec. Holders v. Official Comm. of Unsecured Creditors, 348 F.3d 390, 394-95, 404-05 (3rd Cir. 2003) (upholding an order contemplating that the equity committee financial advisor would rely on information furnished by the debtors' financial advisor); Bettina M. Whyte & Patricia D. Tilton, *Impact on Plan Feasibility of the Compensation and Utilization of Professionals: A Response to "Professionals Paid By Debtors Ought to Represent the Debtors' Interests"*, 1 AM. BANKR. INST. L. REV. 397, 403-04 (1993) (arguing for the sharing of professionals by adverse parties under court-controlled oversight and citing examples of the sharing of professionals by adverse parties).

²⁵In this article, as in our other publications, the "New York court" is the Manhattan Division of the United States Bankruptcy Court for the Southern District of New York.

Case	Nature of representative	Amount paid	Court
Boston Market	Trustee	\$406,980	Phoenix
Cityscape Financial Corp.	Examiner's counsel	\$123,692	White Plains
Global Crossing	Fee examiner and examiner's accountant and counsel	\$9,281,421	New York
Greate Bay Hotel and Casino	Arbitrators	\$89,663	Camden
KMart	Examiner for fee committee	\$532,930	Chicago
Polaroid Corporation	Case examiner, two co-counsel, fee examiner	\$2,294,239	Delaware
Southern Pacific Funding	Liquidating trustee, DIP and creditors committee financial advisor	\$1,210,605	Portland
Special Metals	Auditors	\$115,439	Lexington
SpectraSite Holdings	Examiner	\$18,823	Raleigh
US Airways	Neutral expert	\$191,585	Alexandria
	TOTAL	\$14,204,449	
No fees or expenses were paid to court representatives pursuant to 11 U.S.C. § 503(b)(3) or (4).			

advice reflects the same DIP dominance that appears in the all-fees and expenses comparison, but does not do so as strongly. DIPs paid their lead attorneys \$461 million, more than four times the \$111 million they paid lead

	Amount (in millions)	Amount as a percent of total paid to lead professionals	Number of cases in which role was filled	Percent of cases in which role was filled
DIP lead attorneys	\$460,768,858	45%	74	100%
DIP lead financial advisors	\$344,836,090	34%	72	97%
Creditors' committee lead attorneys	\$111,050,616	11%	67	91%
Creditors' committee lead financial advisors	\$102,075,278	10%	57	77%
TOTAL	\$1,018,730,842	100%	74	

creditors' committee attorneys. DIPs paid their lead financial advisors \$345 million, more than three times the \$102 million they paid lead creditors' committee financial advisors. DIPs had attorneys in every case and financial advisors in all but two. Creditors' committees had attorneys in only 91% of the cases and financial advisors in only 77%.

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B. AMONG PROFESSIONS

Table 4 shows a breakdown of fee and expense awards by profession. Most applicants were attorneys, and most of the money – 54% of the total fees and expenses awarded – went to attorneys. But financial advisors ran a close second, receiving 41% of the total fees and expenses awarded. Another 5% went to accountants and auditors.²⁶ Less than one-half of 1% went to all other professions combined.

TABLE 4. FEE AND EXPENSE AWARDS BY PROFESSION				
	Applications		Fees and expenses	
	Number	Percent	Amount	Percent
Attorneys	501	56.0%	\$879,558,688	53.5
Financial advisors	297	33.2%	\$678,181,037	41.2
Accountants/auditors	60	6.7%	\$80,561,943	4.9
Other professions	17	1.9%	\$5,759,095	0.4
Committees seeking expenses only	19	2.1%	836,125	0.1
TOTAL	894	100.0%	\$1,644,896,888	100.0%
Does not include fees or expenses awarded under 11 U.S.C. § 503(b)(3) or (4).				

Although total awards to attorneys substantially exceeded total awards to financial advisors, a substantial portion of the awards to attorneys were to “special” or “ordinary course” attorneys. Those attorneys generally provided nonbankruptcy services that the debtors would have used and paid for even in the absence of bankruptcy. Thus, to the extent that the fee and expense awards are considered a proxy for the profession’s influence over the course of the sale or restructuring, most of the amounts paid to special or ordinary course counsel should be ignored.²⁷

Substantially all of the special or ordinary course services were provided to DIPs. Table 5 shows those awards totaled \$208,654,910. When that amount is subtracted from the \$879,558,688 amount shown in Table 4 as awarded to attorneys, the remaining \$670,903,778 is less than the \$678,181,037 shown in Table 4 as awarded to financial advisors. Financial advisors probably provided about as much bankruptcy-related service as attorneys in the cases we studied.

Table 5 shows the breakdown by profession of the approximately \$1.3

²⁶Accounting firms often served as financial advisors or as both financial advisors and accountants. In either circumstance, we classified them as financial advisors, not as accountants.

²⁷Some of the services provided by some of the financial advisors are undoubtedly subject to the same caveat. But no financial advisors were designated as “special” or “ordinary course.” We think the proportion of financial advisors’ fees and expenses that would have been incurred in the absence of financial distress is much lower than the proportion of attorneys’ fees and expenses that would have been incurred in that circumstance.

		Firms Sharing		Fees and expenses	
Profession	Variable name	Number	Percent	Amount Paid	Percent
Bankruptcy attorneys	DipBkAtty	116	20%	\$509,525,860	39%
Special attorneys	DipSpecAtty	218	37%	\$208,654,910	16%
Financial advisors	DipFa	192	33%	\$542,522,417	41%
Other professionals	DipOther	61	10%	\$57,025,303	4%
TOTAL	Dip	587	100%	\$1,317,728,490	100%

"Other professionals" includes accountants, auditors, and others

billion in fees and expenses awarded for services provided directly to the DIP. The awards to DIP financial advisors slightly exceed awards to DIP bankruptcy attorneys. Taken together, these figures suggest that attorneys and financial advisors exerted roughly equal influence in large bankruptcy cases during the period of our study.

The results are similar if only fees and expenses paid to lead bankruptcy attorneys and lead financial advisors are considered. Table 3 shows that the amounts paid to DIP lead bankruptcy attorneys, \$461 million, were about 34% higher than the \$345 million paid to DIP lead financial advisors. Table 3 also shows that the amounts paid to lead creditors' committee bankruptcy attorneys, \$111 million, were only about 9% higher than the \$102 million paid to lead creditors' committee financial advisors. The fees and expenses of lead attorneys were not markedly higher than the fees and expense of lead financial advisors.

II. ATTORNEYS' FEES

In this part, we explore the factors that determine the amounts of fees awarded to attorneys in the cases studied. We begin with the fees paid to attorneys who served as bankruptcy counsel to the DIPs.

A. DIP BANKRUPTCY ATTORNEYS' FEES

1. *The Model*

DIP bankruptcy attorneys' fees²⁸ are fees the DIP paid to one or more attorneys representing it with respect to bankruptcy matters in the bankruptcy court. If the debtor filed a parallel bankruptcy case outside the United States, fees awarded by the U.S. bankruptcy court for representation in the parallel case are included in DIP bankruptcy attorneys' fees. Fees the DIP paid to attorneys who provided special representation in nonbankruptcy

²⁸The variable name we used for DIP bankruptcy attorneys' fees is DIPBkAttyOrd, indicating that the variable is the amount of DIP bankruptcy attorneys' fees awarded by the courts as reflected in the courts' orders.

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matters are not included in DIP bankruptcy attorneys' fees.²⁹

In thirty-eight of the seventy-four cases studied (51%), all of the DIP bankruptcy attorneys' fees were paid to a single law firm. In thirty-two cases (43%), the fees were paid to two firms, and in the remaining four cases (5%) the fees were paid to three firms.³⁰ DIP bankruptcy attorneys' fees are important because they indicate the cost to the DIP of its own legal representation in the bankruptcy case.

Table 6 presents a series of three regression models for the determinants of DIP bankruptcy attorneys fees (DipBkAttyFeeOrd). The first model, in column I, uses three independent variables – the log of the assets at filing (lnAssets), the log of the number of days in bankruptcy (lnDaysIn), and the log of the number of DIP bankruptcy attorneys (lnRoleDipBkAtty) – to predict DIP bankruptcy attorneys fees. Two of these variables, lnAssets and lnDaysIn, are statistically significant ($p < .001$), as indicated by the asterisks (***). Alone, they generate an R-squared of .82 in Model I, indicating that these three variables explain 82% of the case-to-case variance in DIP bankruptcy attorneys' fees. Model II adds variables indicating the location of the case in either Delaware (Delaware) or New York (New York) and the year the court confirmed the plan (Trend). These variables are not statistically significant. We added them to compensate for the non-random manner in which we selected our sample.³¹ They do not change the results substantially, indicating that the non-random method of our sample selection had no substantial impact on the relationships measured here.

Of the many other variables we tested in developing Model III, only one was statistically significant. When Skadden, Arps, Meagher & Flom was the DIP lead bankruptcy counsel (DipLeadBkAtty),³² the DIP bankruptcy attorneys' fees (lnDipBkAttyFeeOrd) were significantly higher ($p < .01$). Skad-

²⁹Percentages total 101% due to rounding. In nearly all instances, attorneys classified for the purpose of this study as "special counsel" were designated by the court as "special counsel," "ordinary course counsel," or as a particular type of counsel such as "corporate," "litigation," "employment," or "regulatory."

³⁰In cases where more than one firm represented the DIP as bankruptcy counsel, it was often because the DIP's lead bankruptcy counsel was from another district and the DIP also retained local counsel. In some cases, it was because the DIP filed a parallel bankruptcy case in another country and retained bankruptcy counsel in that country. In one case, it was because the DIP retained separate attorneys to pursue preference recovery. In some cases, the attorneys representing the DIP were listed as "co-counsel." In some cases, the applications we examined did not explain the need for a second or third firm.

³¹The variables Delaware, New York, and Trend are included in Models II and III because our sample was not random with respect to geographical source over time. The sample selection is discussed in *Determinants of Fees Revisited*, *supra* note 6, at 6-7.

³²The DIP lead bankruptcy attorney (DipLeadBkAtty) is the law firm that served as lead counsel for the DIP. We determined which DIP bankruptcy attorney was lead counsel principally from the relative sizes of the fee and expense awards and the frequency with which the firms served as lead counsel in other cases. In every case except Sunterra, the firm we concluded was lead counsel was the DIP bankruptcy attorney firm that received the highest fee and expense award. In Sunterra, a Baltimore case, we concluded that New York-based Willkie Farr & Gallagher was lead counsel and Baltimore-based Whiteford

TABLE 6. DETERMINANTS OF DIP BANKRUPTCY ATTORNEY FEES
(LNDIPBKATTYFEERD)
Dependent variable is the natural log of DIP Bankruptcy Attorney Fees by case
OLS coefficients (SE in parentheses)

	I	II	III
Assets (natural log) lnAssets <i>mean</i> = 6.78, <i>SD</i> = 1.45	0.579*** (0.047)	0.553*** (0.057)	0.511*** (0.057)
Days in bankruptcy (natural log) lnDaysIn <i>mean</i> = 5.72, <i>SD</i> = .80	0.885*** (0.085)	0.885*** (0.086)	0.886*** (0.082)
Number of DIP bankruptcy attorneys (natural log) lnRoleDipBkAtty <i>mean</i> = .37, <i>SD</i> = .39	0.176 (0.174)	0.254 (0.182)	0.344† (0.176)
Delaware <i>mean</i> = .32, <i>SD</i> = .47		-0.136 (0.165)	-0.186 (0.158)
New York <i>mean</i> = .28, <i>SD</i> = .45		0.114 (0.165)	0.108 (0.157)
Trend 1998=0, 2003=5		0.026 (0.047)	0.030 (0.044)
Skadden Arps <i>mean</i> = .14, <i>SD</i> = .34			0.547** (0.196)
Constant	5.782*** (0.533)	5.867*** (0.550)	6.051*** (0.529)
Adjusted R-squared	.82	.82	.83
N	74	74	74

***p <.001, **p < .01, *p < .05, † p < .10

den Arps was DIP lead bankruptcy counsel in ten cases. In those cases, the DIP bankruptcy attorneys' fees were 55% higher than the DIP bankruptcy attorneys' fees in the other sixty-four cases. With Skadden Arps in the model, the R-squared increased slightly to .83, indicating that the three active variables together accounted for 83% of the variance in DIP bankruptcy attorneys' fees across cases. To determine why Skadden Arps representation cost more, we compared Skadden's hourly rates (ProfRateFirm) with the hourly rates other law firms charged. Skadden's rates were not significantly higher.³³ We conclude that Skadden Arps representation cost more in these

Taylor Preston was local counsel, even though Willkie Farr's fee and expense award was only 80% of Whiteford Taylor's.

³³p = .334. This finding may seem to conflict with a finding reported below that Skadden's hourly rate is higher than that of other firms. See *infra* note 92 and accompanying text. The two findings, however, are not comparable. The dependent variable - ProfRateFirm - is the same, but the universe of cases and the level of analysis are different in the two calculations.

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cases because Skadden Arps billed more hours.³⁴

The firms with the next largest number of cases in which they served as DIP lead bankruptcy attorneys were Weil Gotshal & Manges with six, Willkie Farr & Gallagher with five, and Jones Day with four. We tested the DIP bankruptcy attorneys' fees in the cases where each of these firms were DIP lead bankruptcy counsel against the DIP bankruptcy attorneys' fees in all other cases. The fees were not significantly different for any of those firms. No other firm had more than three DIP lead bankruptcy attorneys representations, and we did not test the fees of those other firms. The resulting model appears in Table 6.

DIP bankruptcy attorneys' fees were subject to a scale effect. The effect was large and statistically significant with respect to assets and small and statistically insignificant with respect to case duration. For a 1% increase in assets, the model predicts only a .51% increase in DIP bankruptcy attorneys' fees. Thus, DIP bankruptcy attorneys' fees constitute a much smaller percentage of assets as the size of the debtor company increases. For a 1% increase in case duration, however, the model predicts a .89% increase in DIP bankruptcy attorneys' fees. Our data support the frequently invoked image of a "burn rate" – a fixed expense periodically incurred as long as the case continues – with respect to DIP bankruptcy attorneys' fees.

2. Variables that Did Not Affect DIP Bankruptcy Attorneys' Fees

Several variables that we expected would predict DIP bankruptcy attorneys' fees did not. Adding the number of DIP bankruptcy attorney firms working in the case did not improve the model. Controlling for the size of the debtor and the length of the case, we found that courts did not award higher fees to the DIP's bankruptcy attorneys in cases where two or three firms shared that role. That means hiring local bankruptcy counsel and foreign bankruptcy counsel did not affect significantly the amount of DIP bankruptcy attorneys' fees awarded in U.S. cases.

Neither the Delaware nor the New York court awarded DIP bankruptcy attorneys' fees that were significantly different from those other courts awarded. Delaware Bankruptcy Judge Peter J. Walsh awarded the fees in ten of the seventy-four cases studied (14%). Two other judges, Mary F. Walrath (Delaware Bankruptcy) and Burton R. Lifland (New York Bankruptcy) each awarded the fees in five cases (7%). Controlling for the three variables in our

³⁴Lubben reports that "retention of Weil [Gotshal & Manges] or Skadden [Arps] is not a significant factor in the total cost of a chapter 11 case after controlling for indicators of firm size and time." Lubben, *supra* note 2, at 44. That finding in no way conflicts with ours. Lubben's finding addresses the total cost of a case; our finding addresses only the cost of the DIP's bankruptcy attorneys. With respect to the total cost of a case, our finding is the same as Lubben's: the presence of Skadden Arps did not have a statistically significant effect. See *Determinants of Fees Revisited*, *supra* note 6, at 18 (showing our regression model with no reference to Skadden Arps).

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model, we found that none of these judges awarded DIP bankruptcy attorneys' fees significantly different from the fees all other judges awarded. No other judge awarded fees in more than three cases, and we did not test them.

During a portion of the period our study covered, the Delaware district court had revoked its reference of Chapter 11 cases to the Delaware bankruptcy court. As a result, Delaware district judges awarded the fees in seven of the seventy-four cases we studied (9%). Controlling for the three variables in our model, we found that DIP bankruptcy attorneys' fees awarded by the district judges were not significantly different from DIP bankruptcy attorneys' fees awarded by the bankruptcy judges.³⁵

The conventional wisdom has long been that representation by New York attorneys is more expensive than representation by firms located elsewhere.³⁶ To test that hypothesis, we sought to determine the location of the relevant offices of the law firms that served as DIP lead bankruptcy counsel in each of the seventy-four cases studied.³⁷ In thirty-six of the seventy-four cases (49%), those offices were located in New York City. Controlling for the three variables in our model, we found that when a New York firm was DIP lead bankruptcy counsel (DipLeadBkAtty), DIP bankruptcy counsel (DipBkAtty) charged total fees not significantly different from those they charged when a non-New York firm was DIP lead bankruptcy counsel.³⁸ We conclude that, during the period covered by our study, the conventional wisdom was not correct. DIPs did not pay higher fees for their legal representation when New York-based law firms were at the helm.

Given that attorneys charge for the time they spend traveling from their

³⁵Controlling only for company size and the length of the case, we found that the DIP bankruptcy attorneys' fees awarded by the Delaware district judges were significantly lower ($p = .007$) than the DIP bankruptcy attorneys' fees awarded by the bankruptcy judges. We interpret these findings to mean that the Delaware district judges awarded fees 63% lower than those awarded by bankruptcy judges in all courts.

³⁶For example, in a study of perceptions regarding bankruptcy fees Eisenberg stated:

With respect to fee levels, perceptions may differ, but one also expects substantial interstate variation Fee awards in Wyoming, for example, differ from fee awards in California. This difference is not unique to bankruptcy fees. Legal fees in major metropolitan areas tend to be higher than fees outside those areas.

Theodore Eisenberg, *Differing Perceptions of Attorney Fees in Bankruptcy Cases*, 72 WASH. U. L.Q. 979, 991 (1994). Eisenberg found that "[l]awyers in New York [state] report hourly rates of \$237 compared to a low of \$119 in Ohio." *Id.*

³⁷This determination required the exercise of subjective judgment in some cases where attorneys from offices in different cities combined to provide the representation. In cases where a substantial portion of the representation came from attorneys in two or more cities, we included the names of each city in this variable. That occurred in only one case involving New York. For the purpose of comparing New York with other cities, we counted the case (Geneva Steel in Salt Lake City) as not involving New York lawyers.

³⁸The DIP attorneys' fees included not only the New York lead firm's fees but also the fees of local counsel, co-counsel, or foreign counsel.

offices to court,³⁹ commentators often assume that representation by out-of-town lawyers is more expensive than representation by local lawyers.⁴⁰ To test this assumption, we constructed a variable, Distance, that measured the distance from the city where the offices of the DIP's lead counsel were located to the city where the court was located. If the two cities were the same, we classified the case as "local." If the office city was over 121 miles – the distance from New York to Delaware⁴¹ – from the court city, we classified the case as "long." If the office city was fewer than 121 miles from the court city but not in the court city, we classified the case as "short." (Thus, the cases New York attorneys filed in Delaware were classified as "short.") We also classified as "short" three cases in which local and distant co-counsel shared representation of the DIP. Adding this three-category variable to the model, we found that DIP bankruptcy attorneys' fees were not significantly different across the three classifications.⁴² DIPs do not pay higher fees when the DIP lead bankruptcy attorneys are from out-of-town.

To determine whether the debtor's industry was a significant determinant of the amount of the DIP bankruptcy attorneys' fees paid, we tested the companies in each of the following Standard Industrial Classification⁴³ Divisions by adding each to the model, one at a time: (A) Agriculture, Forestry, and Fishing, (B) Mining, (C) Construction, (D) Manufacturing, (E) Transportation, Communications, Electric, Gas, and Sanitary Services, (F) Wholesale Trade, (G) Retail Trade, (H) Finance, Insurance, Real Estate, and (I) Services. We also tested Major Group 48: Communications⁴⁴ separately. None of these variables was statistically significant, indicating that DIP bank-

³⁹The manner in which travel time is billed varies from court to court and perhaps from firm to firm. Time spent traveling but not working is often billed at half the professional's regular rate. See, e.g., *In re Bennett Funding Group, Inc.*, 213 B.R. 234, 251 (Bankr. N.D.N.Y. 1997).

⁴⁰See, e.g., Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 970 (1999) ("Because debtors who file in Delaware also incur travel expenses for nonlocal professionals and company personnel, the direct costs of forum shopping to Delaware are not trivial."); Note, *Forum Shopping Reconsidered*, 103 HARV. L. REV. 1677, 1684 (1990) ("Three reasons are generally given for policies against forum shopping: . . . second, that forum shopping . . . creates unnecessary expenses as litigants pursue the most favorable, rather than the simplest or closest, forum . . .").

⁴¹We chose this distance because it is probably the longest trip lawyers will make to court that does not require air travel. We hypothesized that air travel would add substantial expense because of the time spent traveling to the airports and waiting for the flights.

⁴²This result held whether we treated the Distance variable as binary or continuous.

⁴³The Standard Industrial Classification (SIC) is the statistical classification standard underlying all establishment-based federal economic statistics classified by industry. OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, STANDARD INDUSTRIAL CLASSIFICATION MANUAL 3 (1987). The classifications consist of broad "Divisions" that are subdivided into smaller "Major Groups," and then subdivided further. Descriptions of the SIC classifications are also available at http://www.osha.gov/pls/imis/sic_manual.html (last visited December 23, 2007).

⁴⁴*Id.*

ruptcy attorneys' fees were not significantly different for debtors in any of these industry classifications.

We noted that in some cases DIPs paid large amounts of fees to DIP financial advisors and only small amounts to DIP bankruptcy attorneys. To test for an inverse ratio of DIP financial advisors' fees to DIP bankruptcy attorneys' fees (a substitution effect), we added DIP financial advisors' fees (DipFaFeeOrd) and the number of DIP financial advisors (RoleDipFa) to the model. Neither variable was significant, indicating that the amounts spent on DIP bankruptcy attorneys and DIP financial advisors are independent of one another.

We tested several other variables in the model. They included (1) whether the company was sold (CoSold,⁴⁵ Emerge,⁴⁶ and 363Sale⁴⁷), (2) whether there was a trend in DIP bankruptcy attorneys' fees over the six years of our study (Trend), and (3) what percentage of hours was billed for the services of paralegals (PctParalegal). None of these variables was significant.

B. DIP SPECIAL COUNSEL FEES.

DIP special counsel fees are attorneys' fees awarded by the bankruptcy court for nonbankruptcy services performed for the DIP. DIP special counsel include attorneys designated as "special counsel" or "ordinary course counsel" in their applications, and a few others that we concluded from review of the fee applications were hired to perform nonbankruptcy work. We assume that nearly all of the fees awarded to special counsel were for work that was not a cost of bankruptcy because it would have been performed even if the debtor had not been in financial difficulty.

As with other fees in bankruptcy cases, fees paid to special counsel are a function of company size, time in bankruptcy, and the number of special counsel firms (Table 7).⁴⁸ There is a significant scale effect in assets. Our model

⁴⁵CoSold is a dummy variable indicating whether the court presided over an auction of the company or a controlling interest in the company during the bankruptcy case. In testing this variable, we omitted piecemeal liquidations occurring during or after the bankruptcy case.

⁴⁶Emerge is a dummy variable indicating whether a stand-alone company emerged from bankruptcy after confirmation of the plan. We tested this variable two ways: first with § 363 sale cases treated as not emerging from bankruptcy and then with § 363 sale cases omitted from the calculation. The Emerge variable was not significant in either test. *Id.*

⁴⁷363Sale is a dummy variable indicating whether all or substantially all of the assets of the debtor were sold before confirmation of a plan of reorganization. *Id.*

⁴⁸Estimating the joint effect of assets, days in bankruptcy, and the number of firms on fees was problematic due to multicollinearity. The number of firms is highly correlated with assets and days in bankruptcy (multiple R = .45). We assume the causal relationship is that larger and longer bankruptcies lead to retention of more special counsel, that the number of special counsel is the proximate cause of the fees, but that using the number of firms in its raw form would result in an underestimation of the influence of assets and days in bankruptcy. Following this assumption, we used a modified, two-stage, least-squares

TABLE 7. DETERMINANTS OF DIP SPECIAL COUNSEL FEES (DIPSPECATTYFEEORD) Dependent variable is the natural log of DIP special counsel fees by case OLS coefficients (SE in parentheses)			
	I	II	III
Assets (natural log) lnAssets <i>mean</i> = 6.96, <i>SD</i> = 1.46	0.440** (0.146)	0.449** (0.121)	0.349* (0.147)
Days in bankruptcy (natural log) lnDaysIn <i>mean</i> = 5.86, <i>SD</i> = .74	0.683* (0.266)	0.660** (0.220)	0.637** (0.224)
Number of special counsel 2SLS residuals RoleSpecAtty <i>mean</i> = -0.067, <i>SD</i> = .76		1.153*** (0.226)	1.141*** (0.234)
Delaware <i>mean</i> = .30, <i>SD</i> = .46			-0.017 (0.422)
New York <i>mean</i> = .28, <i>SD</i> = .45			0.016 (0.435)
Trend 1998=0, 2003=5			0.144 (0.118)
Constant	6.748*** (1.671)	6.898*** (1.382)	7.325*** (1.447)
Adjusted R-squared	.23	.48	.46
N	57	57	57
***p < .001, **p < .01, *p < .05			

estimates that fees will increase 44% when assets double. We also find that the days in bankruptcy variable has a strong influence. The regression suggests a scale effect, but we cannot reject the possibility of a unitary relationship. Adding the number of firms to the model increases the fit significantly (from R-squared of .23 to .48). Each additional firm leads to a doubling of the fees paid. The effect occurs, however, only within a very limited range of the number of firms. We did not detect any difference in fees among courts, nor did we find significant variation over time.

method to estimate the individual influence of assets, days in bankruptcy, and number of firms. That is, we ran two regressions. In the first, we regressed number of firms on assets and days in bankruptcy (R-squared = .20). In the second, we used the residuals from this equation as an independent variable in the regression reported in Table 7. In essence, we identified and removed the covariances that assets and days in bankruptcy share with the number of firms. Any remaining variance (the residuals) is the product of the number of firms.

C. ATTORNEYS' FEES

The attorneys' fees variable (*AttyFeeOrd*) includes all fees awarded to the attorneys for any party to the case, including special counsel. The model we estimated for the prediction of attorneys' fees has four statistically significant independent variables: asset size, the length of the case, the number of law firms working, and whether Skadden Arps was DIP lead bankruptcy counsel in the case (*DipLeadBkAtty*).⁴⁹ We found no significant trend in these fees over time. They did not vary with the court, with whether the company was sold during the reorganization case (*CoSold*, *Emerge*, and *363Sale*), or with the percentage of hours billed for paralegals (*PctParalegal*). We nevertheless included three variables – Trend, Delaware, and New York – in the model because of the method by which we selected our sample.⁵⁰

The three primary determinants of attorneys' fees are essentially the three principal determinants of total professional fees and expenses that we reported in a previous article.⁵¹ The only difference is that the third determinant of attorneys' fees is the log of the number of *attorneys* working, whereas the third determinant of professional fees and expenses is the log of the number of *professional firms* working.

We tested for the possibility that the services of financial advisors were substituted for the services of attorneys in these cases by adding the fees of financial advisors to the model. The results were borderline significant but in the opposite direction we hypothesized. Financial advisors' fees may or may not be higher in the cases with higher attorneys' fees, but they are certainly not lower.

III. FINANCIAL ADVISORS' FEES

In this part, we explore the factors that determine the amounts of fees awarded to financial advisors in the cases studied. We begin with the fees paid to the financial advisors who worked directly for the DIPs.

A. DIP FINANCIAL ADVISORS' FEES

DIP financial advisors' fees are the fees DIPs pay to their financial advisors. DIP financial advisors are firms employed to advise the DIP and provide primarily services other than legal, accounting, auditing, tax return preparation, or real estate brokerage services. They include firms described

⁴⁹This finding with respect to Skadden Arps does not conflict with Lubben's findings. See *supra* note 34.

⁵⁰Our sample is not random. It consists of three sub-samples of roughly equal numbers of cases from Delaware, New York, and all other courts. The Delaware sub-sample is skewed toward older cases; the New York sub-sample is skewed toward newer cases. See *Determinants of Fees Revisited*, *supra* note 6, at 41 (appendix table showing distribution of sample by court).

⁵¹See *Determinants of Fees*, *supra* note 9, at 120-21.

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TABLE 8. DETERMINANTS OF TOTAL ATTORNEYS' FEES FOR THE CASE (ATTYFEEORD)				
Dependent variable is the natural log of all attorneys' fees by case				
OLS coefficients (SE in parentheses)				
	I	II	III	IV
Assets (natural log) lnAssets <i>mean</i> = 6.78, <i>SD</i> = 1.45	0.601*** (0.044)	0.540*** (0.046)	0.524*** (0.055)	0.493*** (0.056)
Days in bankruptcy (natural log) lnDaysIn <i>mean</i> = 5.72, <i>SD</i> = .80	0.923*** (0.081)	0.804*** (0.085)	0.804*** (0.086)	0.790*** (0.084)
Number of law firms (natural log) lnRoleAtty <i>mean</i> = .191, <i>SD</i> = .50		0.468** (0.149)	0.481** (0.152)	0.541*** (0.151)
Delaware <i>mean</i> = .32, <i>SD</i> = .47			-0.133 (0.145)	-0.151 (0.142)
New York <i>mean</i> = .28, <i>SD</i> = .45			0.104 (0.150)	0.106 (0.146)
Trend 1998=0, 2003=5			0.013 (0.040)	0.012 (0.040)
Skadden Arps <i>mean</i> = .13, <i>SD</i> = .34				0.373* (0.185)
Constant	6.011*** (0.508)	6.212*** (0.484)	6.273*** (0.500)	6.410*** (0.494)
Adjusted R-squared	.84	.86	.86	.86
N	74	74	74	74
***p <.001, **p < .01, *p < .05				

as “financial advisors,” “investment bankers,” “restructuring consultants,” “crisis managers,” “financial consultants,” “tax advisors,” and “human resources consultants.”

The model we estimated for the fees of DIP financial advisors appears in Table 9. Recall that three determinants dominated both our professional fees and expenses model and our attorneys' fees model: (1) asset size, (2) case duration, and (3) the number of firms of the category working. In the model presented here, asset size and the number of DIP financial advisors working are less strongly determinative, and case duration is only borderline statistically significant. The most important determinants of the amount of fees paid to DIP financial advisors were Delaware venue and the increase in fees that occurred over the study period. DIP financial advisors' fees were higher in Delaware and increased over the six-year period at a rate of about 33% per year. Surprisingly, the addition of our three sale variables (CoSold, Emerge, and 363Sale) did not improve the model. DIP financial advisors' fees were no

higher in cases where the business was sold.⁵² The implication is that financial advisors' fee contracts may not give financial advisors an incentive to recommend sale over restructuring.

Three possible explanations come to mind for this sharply upward trend in DIP financial advisors' fees. First, DIPs may have been making greater use of financial advisors in the later years our study covered, either in numbers of retentions, the amount of work per retention, or both. Second, the number of large, public company bankruptcy cases filed during the period of our study rose from fifteen in 1996 to ninety-seven in 2001 (and then fell to fifty-seven in 2003).⁵³ An accompanying increase in the demand for bankruptcy financial advisors may have put upward pressure on their fees in the market.⁵⁴ Third, some bankruptcy judges may have been willing to approve higher fees for the same work as a means of attracting the largest cases.⁵⁵ Our data support the first explanation but do not directly address the latter two.

B. FINANCIAL ADVISORS' FEES

Financial advisors were also employed by creditors' and equity committees. For purposes of this study, financial advisors' fees (FaFeeOrd) included all court-awarded fees of financial advisors regardless of the party employing the advisor. Thus, they included DIP financial advisors' fees.

Table 10 shows our model of the determinants of financial advisors' fees. The model employs the same independent variables we used to explain DIP financial advisors' fees. Controlling for the independent variables shown in Model III of Table 10, financial advisors' fees are rising at a rate of about 20% per year. This trend is significant at the .01 level. The model has an adjusted R-squared of .70, indicating that it explains 70% of the case-to-case variance in financial advisors' fees. The Delaware and New York variables are each significant at about the .01 level and their coefficients are .772 and .560 respectively, indicating that the Delaware and New York courts awarded financial advisors' fees about 77% and 56% higher than other courts.

The length of the bankruptcy case is not significant in this model, and indicates at best a weak positive correlation between the number of days the

⁵²For a brief summary of what a financial advisor does in a case where the business is sold, see Bettina M. Whyte & Patricia D. Tilton, *The Financial Advisor's Role in the Purchase or Sale of a Company*, AM. BANKR. INST. J., November 1996, at 24.

⁵³Lynn M. LoPucki's Bankruptcy Research Database, <http://lopucki.law.ucla.edu> (last visited December 23, 2007).

⁵⁴We are skeptical, however, because our preliminary study shows continuing increases in total professional fees and expenses in recent years when the demand for large bankruptcy case professionals has been low. See Bernard Wysocki, Jr., *Rising Fees Charged in Bankruptcy Cases Elicit a Backlash*, WALL ST. J., Aug. 4, 2007 at B1 (reporting our estimate of a 12% rise per year over the period 1998-2007).

⁵⁵See LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* 141-43 (2005).

TABLE 9. DETERMINANTS OF DIP FINANCIAL ADVISORS' FEES (DIPFAFEEORD)				
Dependent variable is the natural log of fees paid to DIP financial advisors OLS coefficients (SE in parentheses)				
	I	II	III	IV
Assets (natural log) lnAssets <i>mean</i> = 6.84, <i>SD</i> = 1.42	0.630*** (0.111)	0.396** (0.131)	0.314* (0.129)	0.308* (0.124)
Days in bankruptcy (natural log) lnDaysIn <i>mean</i> = 5.72, <i>SD</i> = .81	0.444* (0.195)	0.384* (0.179)	0.241 (0.179)	0.281† (0.173)
Delaware <i>mean</i> = .33, <i>SD</i> = .47		0.906** (0.336)	0.759* (0.325)	0.946** (0.322)
New York <i>mean</i> = .26, <i>SD</i> = .44		0.062 (0.361)	0.177 (0.346)	0.253 (0.335)
Trend 1998=0, 2003=5		0.334** (0.104)	0.248* (0.104)	0.256* (0.100)
Number of DIP financial advisors (natural log) lnRoleDipFa <i>mean</i> = 1.22, <i>SD</i> = .44			1.079** (0.396)	1.020** (0.382)
KPMG <i>mean</i> = .06, <i>SD</i> = .23				-1.429* (0.581)
Constant	8.029*** (1.230)	8.740*** (1.169)	9.061*** (1.120)	8.921 (1.079)
Adjusted R-squared	.38	.48	.53	.56
N	72	72	72	72
***p < .001, **p < .01, *p < .05, † p < .10				

debtor remains in bankruptcy and the amounts of fees awarded to financial advisors. This finding is surprising because financial advisors' fee agreements commonly provide for payment of a fixed monthly amount in addition to a transaction fee. The likely explanation is that case duration is a principal determinant of the number of financial advisors working on a case, so the two variables are correlated.⁵⁶ When the number of financial advisors is added to Model II, case duration ceases to be significant because it is correlated with the number of financial advisors. The number of financial advisors is the more proximate cause of changes in fees.

In Model I of Table 10, the presence of a case in New York appears to be unrelated to the amount of financial advisors' fees paid. But in Model II, when we control for the number of financial advisors working, the presence of the case in New York is significant. We think Table 11 provides the

⁵⁶See *infra* Table 11.

TABLE 10. THE DETERMINANTS OF FINANCIAL ADVISORS' FEES (FAFEEORD)
 Dependent variable is the natural log of all financial advisors' fees by case
 OLS coefficients (SE in parentheses)

	I	II	III
Assets (natural log), lnAssets <i>mean</i> = 6.78, <i>SD</i> = 1.42	0.420*** (0.087)	0.285** (0.088)	0.279** (0.085)
Days in bankruptcy (natural log), lnDayIn <i>mean</i> = 5.72, <i>SD</i> = .80	0.360** (0.133)	0.164 (0.133)	0.182 (0.129)
Delaware <i>mean</i> = .32, <i>SD</i> = .47	0.793** (0.250)	0.651** (0.232)	0.772*** (0.231)
New York <i>mean</i> = .28, <i>SD</i> = .45	0.302 (0.256)	0.511* (0.241)	0.560** (0.235)
Trend 1998=0, 2003=5	0.301*** (0.070)	0.195** (0.070)	0.198** (0.070)
Number of financial advisors, RoleFa <i>mean</i> = 1.52, <i>SD</i> = .48		1.135*** (0.308)	1.142*** (0.298)
KPMG <i>mean</i> = .05, <i>SD</i> = .22			-0.979* (0.431)
Constant	9.148*** (0.859)	9.720*** (0.802)	9.635*** (0.800)
Adjusted R-squared	.62	.68	.70
N	72	72	72

***p < .001, **p < .01, *p < .05

explanation. Table 11 shows that when we control for the size and duration of the case and the trend in fees over time, smaller numbers of financial advisors work in New York cases. A smaller number of financial advisors in New York cases is generating the same fees as a larger number of financial advisors in other courts.

C. THE NUMBERS OF FINANCIAL ADVISORS WORKING

The preceding subpart demonstrates that the number of financial advisors working was a significant determinant of financial advisors' fees in the cases studied. To identify the ultimate determinants of financial advisors' fees, we estimated a regression model with the number of financial advisors in the case as the dependent variable.

That model appears in Table 11. It shows that the number of financial

advisors in a case increases significantly with company size⁵⁷ and the length of the case.⁵⁸ Controlling for these two variables, we found that the number of financial advisors in the cases studied was increasing at a rate of about 9% per year.⁵⁹ The number of financial advisors per case increased by about 54% over the six-year period of our study.

Table 10 shows that this rise in the number of financial advisors per case is merely one component of an even more rapid rise in the total fees paid to financial advisors in each case. Even controlling for the increase in the number of financial advisors per case, we found that financial advisors' fees are rising at the rate of 22% per year.

TABLE 11. DETERMINANTS OF THE NUMBER OF FINANCIAL ADVISORS WORKING (ROLEFA)
 Dependent variable is the number of financial advisors by case
 OLS coefficients (SE in parentheses)

	I	II
Assets (natural log) lnAssets <i>mean</i> = 6.78, <i>SD</i> = 1.45	0.175*** (0.030)	0.118*** (0.032)
Days in bankruptcy (natural log) lnDaysIn <i>mean</i> = 5.72, <i>SD</i> = .80	0.195*** (0.055)	0.173** (0.049)
Delaware <i>mean</i> = .32, <i>SD</i> = .47		0.125 (0.092)
New York <i>mean</i> = .28, <i>SD</i> = .45		-0.184 (0.094)
Trend 1998=0, 2003=5		0.094*** (0.026)
Constant	-.783* (0.343)	-0.504 (0.315)
Adjusted R-squared	.43	.55
N	74	74

***p < .001, **p < .01, *p < .05

This trend toward greater use of financial advisors in chapter 11 cases of large public companies appears to have existed for a long time. A study by LoPucki and Whitford of forty-three large, public company bankruptcies in

⁵⁷p < .001.

⁵⁸p < .001.

⁵⁹p < .001

the 1980s reported the existence of creditors' committees in forty-two of forty-three cases (98%).⁶⁰ We found that creditors' committees filed at least one application for professional fees in sixty-seven of seventy-four cases (91%). The difference between these rates is not statistically significant.⁶¹ LoPucki and Whitford also found that creditors' committees retained financial advisors in only twenty of the forty-two cases (48%) in which a committee existed.⁶² We, on the other hand, found that creditors committees retained financial advisors in fifty-nine of the sixty-seven cases (88%) in which a committee applied for professional fees.⁶³ The difference in these rates is statistically significant at the .001 level.⁶⁴ Creditors' committees were significantly more likely to employ financial advisors during the period of our study than in the 1980s.

LoPucki and Whitford reported the existence of equity committees in twenty-two of forty-three cases (51%).⁶⁵ We found that equity committees filed at least one application for professional fees in only three of seventy-four cases (4%). This difference is significant at the .001 level.⁶⁶ Official equity committees were significantly less likely to come into existence during the period of our study than they were in the 1980s.

LoPucki and Whitford found that the equity committees retained investment bankers in seven of the twenty-two cases (27%) in which such committees existed.⁶⁷ By contrast, we found that equity committees retained financial advisors in three of three cases (100%) in which the equity committee filed at least one application for professional fees.⁶⁸ Equity committees in the 1980s were less likely to retain financial advisors than equity committees in the period of our study.

The two trends cut in opposite directions. Today, equity committees are

⁶⁰See *Bargaining over Equity's Share*, *supra* note 12, at 139 (table indicating the number of official creditors' committees in each case).

⁶¹Fisher Exact, $p=.27$. Although these data were collected by different standards, we do not believe the standards made any difference in the totals. That is, we do not believe that official committees fail to retain at least one professional in any significant number of cases.

⁶²See Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies, 1979-88*, DS44 Sorted Data, question 3 (1998) (raw data), available at <http://www.icpsr.umich.edu/ICPSR> [hereinafter *Patterns Data*]; but see Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 765 n.308 (reporting that "creditors' committees hired investment bankers in at least 16 cases") [hereinafter *Corporate Governance*]. Creditors' committees hired accountants as financial advisors in four other cases. See *Patterns Data*.

⁶³The difference in the rates at which committees came into existence is not statistically significant.

⁶⁴Fisher Exact, two-tailed, $p < .001$.

⁶⁵See *Bargaining over Equity's Share*, *supra* note 12, at 139.

⁶⁶Fisher Exact, two-tailed, $p < .001$.

⁶⁷See *Corporate Governance*, *supra* note 62, at 765 n.308 (reporting that equity committees hired investment bankers in at least seven cases).

⁶⁸Fisher Exact, two-tailed, $p = .10$.

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TABLE 12. RETENTION OF FINANCIAL ADVISORS

Study period	Committee type	Cases	Cases with committees	Percent of cases with committees	Cases with financial advisors	Percent of committee cases with financial advisors	Percent of all cases with financial advisors
1980-1988	Creditors committees	43	42	98%	20	48%	47%
	Equity committees	43	22	51%	7	27%	16%
	Combined committees	86	64	74%	27	42%	31%
1998-2003	Creditors committees	74	67	91%	59	88%	80%
	Equity committees	74	3	4%	3	100%	4%
	Combined committees	148	70	47%	62	89%	42%

In calculating the statistics for "all committees" we counted all creditors' committees in a case as one committee and counted that committee as having a financial advisor if any of the creditors' committees had a financial advisor. We did the same with respect to equity committees.

less likely to be appointed. But once appointed, equity committees are more likely to retain financial advisors. On the whole, the proportion of cases in which equity committees retain financial advisors has fallen significantly since the 1980s.⁶⁹

The increased hiring of financial advisors by creditors' committees, however, outweighs the decreased hiring by equity committees. Combining the two sets of data, we find that the likelihood some committee (equity or creditors') will form and will hire financial advisors has increased significantly since the 1980s.⁷⁰ The market for financial advisors to bankruptcy committees has been expanding. Precise data on DIP hiring of financial advisors are not available, but the data that do exist suggest that DIP hiring of financial advisors has also increased.⁷¹

⁶⁹We found equity committees retained financial advisors in three cases and did not in seventy-one cases. LoPucki and Whitford found equity committees retained financial advisors in "at least seven" cases. See *Corporate Governance*, *supra* note 62, at 765 n.308. If that number were exactly seven, it would leave thirty-six cases in which equity committees did not retain financial advisors. On a Fisher Exact test, two-tailed, $p = .057$.

⁷⁰We found that equity and creditors' committees retained financial advisors in sixty-two instances and did not in eighty-six instances. LoPucki and Whitford found equity and creditors' committees retained financial advisors in twenty-seven instances and did not in fifty-nine instances. On a Fisher Exact test, two-tailed, $p = .144$.

⁷¹LoPucki and Whitford did not systematically collect data on the rate at which DIPs retained financial advisors. See *Corporate Governance*, *supra* note 62, at 765 n.308 ("Debtors consulted investment bankers even more frequently, but we did not systematically collect this information from debtors."). Their raw data show the absence of investment bankers from twelve of forty-three cases (28%). See

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IV. HOURLY RATES CHARGED

The lodestar – “calculated as the number of hours reasonably expended multiplied by a reasonable hourly rate”⁷² – plays a central role in the fee award process. Courts can commit in advance to other methods of determining fees⁷³ and can deviate from the lodestar in determining fees after the work is done.⁷⁴ But the lodestar is generally the starting point for analysis.

In their final fee applications, law firms typically indicate the billing rates and hours worked for each lawyer on the case. In accordance with the U.S. Trustee’s guidelines,⁷⁵ most applicants indicate a “blended rate” – a rate that ignores the different rates of individual professionals and simply divides the total fees by the total number of hours worked (exclusive of paralegal hours). Regardless whether the applications indicated a blended rate, we calculated one by dividing the total fees sought by the total hours reported.

Investment banks serving as financial advisors present a special problem because those firms do not keep time records or charge hourly rates when they do nonbankruptcy work. Bankruptcy courts typically require that investment bankers begin keeping time records when the courts authorize their employment. Presumably, the purpose is to make possible the calculation of the lodestar as a means of testing the reasonableness of the banker’s fees.

Judicial decisions often suggest that this requirement limits the fees of financial advisors to levels comparable to attorneys fees. For example, in *In re Commercial Fin. Servs., Inc.*,⁷⁶ a prominent investment banking firm, Houlihan Lokey Howard & Zulkin Capital, sought a monthly fee that worked out to more than \$700 an hour.⁷⁷ Noting that Houlihan’s services in the case had not been “exceptional,”⁷⁸ based on the lodestar the bankruptcy court reduced them to less than one-half the amount sought.⁷⁹ The Tenth Circuit Bankruptcy Appellate Panel affirmed the reduction.⁸⁰

Our data present a very different picture. Table 13 shows the seventeen highest hourly rates (fees awarded divided by hours worked) in the represen-

Patterns Data, *supra* note 62. The raw data from our study show the absence of financial advisors from only two of seventy-four cases (3%).

⁷²*Stalnaker v. DLC, Ltd.*, 376 F.3d 819, 825 (8th Cir. 2004).

⁷³*In re Texas Sec., Inc.*, 218 F.3d 443, 445-46 (5th Cir. 2000) (holding that absent changed circumstances, a bankruptcy court may not revert to the lodestar formula to compute a professional’s compensation when the court has previously approved a hybrid contingent fee/hourly rate formula under § 328(a)).

⁷⁴*E.g.*, *Miniscribe Corp. v. Harris Trust Co. of Cal.*, 309 F.3d 1234, 1245 (10th Cir. 2002) (affirming a fee award equal to the lodestar multiplied by 2.57).

⁷⁵28 C.F.R. pt. 58, app. A (2007).

⁷⁶298 B.R. 733 (B.A.P. 10th Cir. 2003).

⁷⁷*Id.* at 743.

⁷⁸*Id.* at 747.

⁷⁹*Id.* at 745.

⁸⁰*Id.* at 747.

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tations we studied. The highest was \$18,539 per hour, awarded to Lazard Freres in SpectraSite Holdings. The seventeenth highest rate was \$1,245 per hour. Sixteen of the seventeen awards were to financial advisors.⁸¹

Examination of the seventeen fee applications reveals that in almost every instance - including one in which the financial advisor worked for the creditors' committee - the bulk of the award was a "transaction fee," a fee fixed as a percentage of the assets to be reorganized or sold. The fee was earned on consummation of the sale or reorganization. The fee application recited the number of hours worked from the commencement of the case to the date of the post-confirmation application and the amount of the fees due under the employment contract. In none of the seventeen representations in Table 13 did the application indicate a blended hourly rate, as the U.S. Trustee's guidelines recommend.⁸² To determine the hourly rates requested and awarded, we therefore divided the fees requested and awarded for the compensation period by the hours worked during that period.

Debtor's name/ Court	Professional firm/Firm's role in case	Fees applied for	Hours reported	Months worked before	Months worked during	Hourly rate sought	Hourly rate awarded	Debtor's assets in millions
SpectraSite Holdings Raleigh	Lazard Freres DIP Investment Banker	\$8,550,000	461	4	2	\$18,539	\$18,539	\$742
Genuity Inc. New York	Lazard Freres DIP Investment Banker	\$6,250,000	695	4	2	\$8,993	\$8,993	\$1,944
XO Communications New York	Houlihan Lokey DIP Financial Advisor	\$19,233,333	2,262	8	5	\$8,505	Contested	\$8,700
Williams Communications New York	Blackstone Group DIP Financial Advisor	\$17,096,774	3,264	6	6	\$5,239	\$5,239	\$5,992
Conseco Chicago	Lazard Freres DIP Investment Banker	\$21,001,276	4,093	4	9	\$5,132	\$5,132	\$52,286
Hayes Lemmerz Delaware	Chanin Capital Creditors' committee Financial Advisor	\$4,448,000	1,029	0	18	\$4,325	\$4,325	\$2,802

⁸¹One of the seventeen awards was to a law firm. The court awarded Much Shelist \$1,323 per hour for its work as conflicts counsel to the creditors' committee in the Conseco case. The firm was employed on a 15% contingent fee basis to recover preferences and fraudulent transfers.

⁸²See 28 C.F.R. pt. 58, app. A (2007) ("All applications should contain a summary or cover sheet that provides a synopsis of the following information: . . . Computation of blended hourly rate for persons who billed time during period, excluding paralegal or other paraprofessional.").

Global Crossing New York	Blackstone Group DIP Financial Advisor	\$24,400,000	7,213	2	23	\$3,383	\$3,383	\$22,438
Flag Telecom New York	Blackstone Group DIP Financial Advisor	\$10,332,823	3,642	2	6	\$2,837	\$2,837	\$3,335
Focal Communications Delaware	Miller Buckfire DIP Financial Advisor & Investment Banker	\$3,200,000	1,156	3	6	\$2,768	\$1,793	\$561
Pinnacle Holdings New York	The Gordian Group DIP Financial Advisor	\$3,075,000	1,715	5	5	\$1,793	\$1,793	\$1,003
Polaroid Delaware	Miller Buckfire DIP Financial Advisor & Investment Banker	\$7,649,644	4,571	5	10	\$1,673	\$1,373	\$1,801
Guilford Mills New York	Rothschild DIP Investment Banker	\$2,637,097	1,631	4	7	\$1,617	\$1,617	\$551
Sunbeam New York	Dresdner Kleinwort DIP Investment Banker	\$378,572	246	2	4	\$1,538	\$1,538	\$2,960
Bethlehem Steel New York	Greenhill and Co. DIP Financial Advisor	\$7,050,000	5,027	4	20	\$1,402	\$1,402	\$4,200
Conseco Chicago	Much Shelist Creditors' committee Conflicts Counsel (CFC Debtors)	\$1,794,034	1,380	0	10	\$1,322	\$1,300	\$52,286
Metromedia Fiber Networks White Plains	Lazard Freres Creditors' committee Financial Advisor	\$2,650,000	2,040	0	16	\$1,299	\$1,299	\$7,024
XO Communications New York	Jeffries & Co. Creditors' committee Financial Advisor	\$935,000	751	0	7	\$1,245	\$978	\$8,700

In thirteen of the seventeen representations, an investment bank sought the fee for services provided to the DIP. In each of those thirteen representations, the investment bank entered into a pre-petition contract and began providing services a few months before bankruptcy. Some might seek to justify the high post-petition hourly rates charged by arguing that the investment banks had to do a substantial amount of unreported pre-petition work in addition to the reported post-petition work. That justification is not plausible. First, the work is unreported: none of the thirteen applications sought

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fees for pre-petition work⁸³ or reported hours worked prior to bankruptcy. Second, even if the applications had sought compensation for pre-petition work, that compensation would not have been properly payable.⁸⁴

Another putative justification would concede that investment banks could not be paid post-petition for pre-petition work and would instead argue that the court could consider the pre-petition work in determining whether the transaction fees – earned entirely post-petition when the contingencies occurred – were reasonable.

This argument likewise fails to justify the hourly rates shown in Table 13. First, the courts awarded fees for advising creditors' committees in three cases. Those committees were not appointed pre-petition and so the investment banks could not have worked for them pre-petition. One of the rates was a stunning \$4,325 per hour. Second, in most of the remaining cases the investment banks worked for only brief periods pre-petition. That suggests most of the hours worked were reported, and the unreported hours would not have had a substantial effect on the blended rate. Third, the time records the investment banks did furnish – probably at some substantial effort considering they do not regularly keep such records – appear to have served no purpose. For the post-petition fees to be justified on the basis of pre-petition work, the investment banks would have had to furnish at least some information as to the extent of that work. They furnished none. For all the courts or the public know, the investment banks did only trivial amounts of pre-petition work.

Nor does the pre-petition nature of the work justify the investment bankers' failure to record their time. Bankruptcy Rule 2016(a) requires that “[a]n entity seeking . . . compensation for services . . . from the estate shall file an application setting forth a detailed statement of . . . the services rendered [and the] time expended”⁸⁵ Even if a court could award compensation for pre-petition work, the rule would require time records for that work. The rule makes no exception for pre-petition work or work pursuant to transaction fee contracts.

In most of the cases, the investment bankers must have known at some

⁸³Fifteen applicants in twelve of the seventy-four cases studied (16%) applied for fees earned pre-petition. Twelve of those fifteen applications were granted in the full amounts sought. Ten of the 12 (83%) were in Delaware or New York. Of all applications in the cases studied, 561 of 927 (61%) were filed in the those two courts. The differences between the courts is not statistically significant (Fisher Exact $p = .18$).

⁸⁴As a legal matter, the debtor's obligation to pay for the investment banker's pre-filing services constituted a non-priority unsecured claim in the bankruptcy case, 11 U.S.C. §§ 502(b), 506(a), that was discharged by the confirmation order, 11 U.S.C. § 1141(d). The court can award professional fees as an expense of administration only to “a professional person employed under section 327.” 11 U.S.C. § 330(a)(1).

⁸⁵FED. R. BANKR. P. 2016(a).

point pre-petition that the debtor would file bankruptcy. Often, it would have been at the moment of their engagement. They could have begun keeping time records then. Had they done so, the resulting records would have provided a meaningful basis on which to evaluate their fees. That they did not suggests the records would have weakened rather than strengthened their fee applications.

An argument might be made for dispensing with the record-keeping requirement for investment banks. But so long as it remains and the investment banks choose not to keep time records and report their pre-petition hours, the investment banks should not complain that those hours are not taken into account in calculating their hourly rates.

Of the seventeen highest awards, ten (59%) were made by the New York bankruptcy court. That court made only 180 of the 410 fee awards we studied (44%). The difference is statistically significant at the .03 level. The New York court is more likely than other courts to award fees to investment banks at very high hourly rates.⁸⁶

A. BLENDED HOURLY RATES

The blended hourly rates of the 314 applicants in the twenty-six cases studied ranged from \$18,539 per hour⁸⁷ to \$64 per hour.⁸⁸ The average rate was \$565 per hour, the median rate \$356 per hour.

To identify the determinants of these blended hourly rates, we estimated a regression model. We found that financial advisors charged significantly higher rates than attorneys or accountants,⁸⁹ but that attorneys and accountants charged rates similar to each other.⁹⁰ (Table 14).

We were able to identify four investment banking firms whose hourly rates were significantly higher than the hourly rates of other professionals. The fees of these four firms were only about 25% of all fees paid in the

⁸⁶The New York court also awarded higher fees to financial advisors overall. *See supra*, Table 10.

⁸⁷*See* Table 13.

⁸⁸The Unofficial Committee of Noteholders in the Flag Telecom case applied for only \$125,000 (12%) of the \$1,050,000 in fees their attorneys, Kasowitz, Benson, Torres & Friedman LLP, charged. The Committee did not seek full reimbursement for a variety of reasons and may not have been legally entitled to full reimbursement because the Committee was not Official. *See* Limited Application of the Steering Committee of Noteholders of Flag Telecom Holdings Limited for Allowance of Compensation for Legal Fees and for Reimbursement of Expenses Pursuant to 11 U.S.C. §503(b), In re Flag Telecom Holdings Limited, No. 02-11732 (Bankr. S.D.N.Y. Nov. 8, 2002).

⁸⁹We identified firms as "accountants" or "financial advisors" based on the capacity in which they were employed as described in the fee applications. Many accounting firms – including Arthur Andersen, Deloitte & Touche, PricewaterhouseCoopers, and Ernst & Young – provide both kinds of services. We classified firms as accountants when they reported accounting, auditing, or tax preparation work. We classified them as financial advisors when they reported financial advising, consulting, or tax planning work.

⁹⁰ $p < .001$.

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twenty-six cases for which we have fee data. In the model, however, their presence explains an additional 33% of the variance in hourly rates (over and above the 10% generically explained by the attorney and financial advisor variables alone).⁹¹

We found no other overall determinant of blended hourly rates. Rates did not differ significantly by where the court was located, by how large the debtor was, or by whether the professional represented a DIP or a creditors' committee. New York courts do not award higher hourly rates on average, and hourly rates are not higher in larger cases.

TABLE 14. THE DETERMINANTS OF PROFESSIONALS' HOURLY RATES (PROFRATEFIRM)		
Dependent variable is the natural log of hourly rates by application		
OLS coefficients (SE in parentheses)		
	I	II
Financial advisor <i>mean</i> = .30, <i>SD</i> = .46	0.576*** (0.152)	0.313** (0.121)
Attorney <i>mean</i> = .63, <i>SD</i> = .48	0.143 (0.141)	0.143 (0.113)
Blackstone <i>mean</i> = .01, <i>SD</i> = .10		2.241*** (0.289)
Chanin Co. <i>mean</i> = .01, <i>SD</i> = .10		0.605* (0.289)
Houlihan Lokey <i>mean</i> = .01, <i>SD</i> = .10		1.478*** (0.289)
Lazard Freres <i>mean</i> = .02, <i>SD</i> = .13		2.339*** (0.226)
Constant	5.659*** (0.134)	5.659*** (0.107)
Adjusted R-squared	.10	.43
N	312	312
***p < .001, **p < .01, *p < .05		

When we limited the model to the rates of law firms, we found that the rates of Skadden Arps were significantly higher than the rates of other firms.⁹² We also found that creditors' committees paid significantly higher rates than DIPs paid.⁹³ In this model, we controlled for the percentage of the

⁹¹See *infra* Table 14, Model II.

⁹²p = .009.

⁹³p = .013

fees paralegals billed, but that variable was not statistically significant. The hourly rates of attorneys did not differ significantly by court or by debtor size.

B. HIGHEST RATE CHARGED BY THE FIRM

HighRateFirm is the highest rate charged by any professional in the firm. Journalists often focus on this rate when they write about large bankruptcy cases.⁹⁴ We included only the HighRateFirm of attorneys in our model. After testing numerous variables, we were able to identify only one with a statistically significant relationship to attorneys' HighRateFirm. HighRateFirm for Skadden Arps was significantly higher than HighRateFirm for all other law firms.⁹⁵

V. CONCLUSIONS

Over the past two decades, courts have authorized the employment of larger numbers of financial advisors and awarded higher fees for those employed. These trends continued during the six-year period this empirical study covers. In combination, they have substantially increased financial advisors' fees and fee shares. DIP financial advisors' fees and total financial advisors' fees grew at the astonishing rates of 26% per year and 22% per year, respectively. The Delaware and New York bankruptcy courts are at the vanguard of these changes. By the end of the period studied, the fees courts were awarding to financial advisors roughly equaled the fees courts were awarding to attorneys.⁹⁶ When professionals are paid, they do what they have been trained to do. Financial advisors generate financial solutions to financial problems. Lawyers generate legal solutions to legal problems. Thus, we think this change in the relative proportions of fees paid the two professions signals a change in bankruptcy reorganization from a principally legal process to one that is more heavily financial.

In the reorganizations of the 1980s, creditors committees rarely had their own financial advisors. Today, they have them in the large majority of cases. This is not to say, however, that the power professional advice and represen-

⁹⁴See, e.g., Bill Vlasic, *Many cash in on Delphi; Supplier puts squeeze on workers while richly paying lawyers and clerks to help with bankruptcy*, DETROIT NEWS, Nov. 30, 2005, at 1A (reporting numerous high hourly rates for bankruptcy professionals and stating "[b]ut even as Delphi is asking its employees to cut their hourly pay from about \$27 to \$12.50, the company is paying top dollar to a battery of lawyers and restructuring consultants - including as much as \$55 an hour for clerical help to input computer data.").

⁹⁵ $p < .001$.

⁹⁶This estimate is based on two findings. First, courts awarded 53.5% of all fees to attorneys and 41.2% of all fees to financial advisors. See *supra* Table 4. Second, financial advisors' awards rose at the rate of 22% per year, while attorneys' awards rose at the rate of only about 1% per year. See *supra* Table 8 and Table 10.

tation confer has become more evenly balanced among constituencies. More than 80% of professional fees awarded go to professional employed by DIPs. Only 19% are awarded to professionals employed by creditors' committees. By the time of our study, equity committees - which routinely retained counsel in the large public company bankruptcy cases of the 1980s - had become rare. Professionals representing or advising equity committees in the cases we studied received only one-half of 1% of court-awarded fees.

DIPs pay substantial amounts to professionals who represent and advise secured creditors and DIP lenders. These professionals are not required to participate in the visible fee award system, and so their fees are not reflected in the findings of this study. We were, however, able to estimate the amounts DIPs paid them. If we include those amounts, DIPs paid 57% for professionals they employed, 30% for professionals secured creditors and DIP lenders employed, 13% for professionals creditors' committees employed, and only 1% for professionals equity committees and courts employed. To the extent that fees are a proxy for power, DIPs still dominate the bankruptcy reorganization process.

In earlier work, we presented a regression model in which three factors - asset size, case duration, and the number of professional firms working - explained 85% of the variation in total professional fees and expenses in the cases studied. That basic model - substituting law firms for professional firms - explains 86% of the case-to-case variation in attorneys' fees in the same cases. But the basic model explained only about 70% of the case-to-case variation in financial advisors' fees. The number of financial advisors working, together with a powerful upward trend in the fees over time and a propensity for the Delaware and New York courts to award more fees to financial advisors, dominated our model of financial advisors' fees to the extent that asset size and case duration were only marginally significant. The steep upward trend in their fees, combined with the imbalance in fee awards among courts, suggests that the role of financial advisors in large public company bankruptcies remains very much in transition. Financial advisors will become even more powerful.

Our model of the determinants of DIP bankruptcy attorneys' fees explained 82% of the variance with just two factors: case size and duration. Whether the DIP hired local or foreign counsel did not have a statistically significant effect because the amounts were so small and were paid so infrequently.

Surprisingly, whether the debtor sold its business or sold some interest in its business had no significant effect on DIP financial advisors' fees and only a marginally significant effect on total financial advisors' fees. It had the latter effect only with respect to one of the three variables we used as a proxy for sale activity. The DIP's financial advisors do not make significantly more

money when the DIP sells its business through bankruptcy.⁹⁷

We found fee awards to investment bankers at shockingly high rates – up to \$18,000 per hour. Although the investment bankers typically commenced work pre-petition, their applications did not report pre-petition hours worked. Nor did those applications show post-petition hourly rates. If hourly rates are relevant, the fees awarded are too high. If hourly rates are not relevant, the system should not require the investment bankers to keep and report their hours.

When they authorize parties to retain attorneys, the bankruptcy courts try to control fees by regulating hourly rates. When journalists complain about the expense of large bankruptcy reorganization cases, they, too, generally focus on hourly rates. We found, however, that the differences in hourly rates among the professionals who billed by the hour had no significant effect on any category of fees. That is, the variation in hourly rates among the members of a profession do not significantly explain the case-to-case variations in total fees awarded. It follows that controlling professionals' hourly rates is not an effective means for controlling the costs of bankruptcy reorganization.

⁹⁷One possible explanation might be that financial advisors' fees in sale cases are depressed by sale prices that are low in comparison with reorganization recoveries. See Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 3-4 (2007) (finding reorganization recoveries to be more than double sale recoveries).