UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

ARNOLD GREGORY MEMORIAL HOSPITAL, INC.

Case No. 89-10938 K

Debtor

DECISION

It is not my intention to "write" frequently on fee allowances. I do so here not because anything novel is presented in this case, but because this case provides a suitable vehicle for explaining my approach (typically not enunciated) to the awarding of fees.

This decision will not be published, but a redacted copy (with the case caption, names, and other identity data deleted) will be distributed locally for the advice of the Bar.

On or about April 12, 1989, Arnold Gregory Memorial Hospital, Inc. ("Debtor") retained the firm of Underberg & Kessler ("the firm") regarding the prospect of filing Chapter 11 upon the recommendation of the Debtor's general counsel and its financial consultants. (The debtor had been advised that its primary lender and secured creditor had demanded full payment of approximately $700,000 it was owed and that the lender intended to foreclose on its security interest in the Debtor's personal property.) The ensuing consultations resulted in the filing of the Chapter 11 Petition on April 20, 1989. The lender would not consent to the use of its cash collateral, and this Court, after appropriate

hearings, denied the Debtor's request for an Order approving its use of cash collateral over the lender's objection. Although the Debtor's case could not be involuntarily converted to a Chapter 7 because it was a not-for-profit hospital, the Debtor consented to conversion on May 20, 1989 (just one month after the filing of the Chapter 11 Petition) and the Order of Conversion was signed on May 22, 1989.

Now before the Court is the firm's application for allowance of compensation as attorneys for the Debtor. I characterize the application as one in which the firm seeks fees for three time periods. The first is in the amount of $4,490.00 for the period April 12, 1989 to April 19, 1989 - a one week period - consisting of approximately thirty hours, most of which was billed at the rate of $140.00 per hour and some of which was billed at the rate of $165.00 per hour.

For the one month period between the filing of the Chapter 11 Petition and the filing of the Consent to Conversion, the firm seeks $12,505.00 for work performed by various persons at different rates. The total hours were 88.5. Consequently, these hours were billed at an average rate of approximately $141.00. (The specific rates charged for each service are set forth in the firm's application.)

For work performed thereafter up until October 2, 1989 the firm seeks $3,837.50, consisting of twenty-nine (29) hours of work, thus representing an average billing rate of $132.32 per

hour.

The total application, therefore, is for $20,832.50 for 147.25 hours of work. Additionally reimbursement of $1,501.32 in disbursements is requested.

These requests have been partially opposed by the United States Trustee and by the lender, Anchor Savings Bank, F.S.B. (Because of certain stipulations in this case, the fees will be paid from a fund the balance of which will belong to the lender.)

The United States Trustee argues as follows: that the fact that the Debtor was only in Chapter 11 for one month gives rise to a presumption that the Debtor should have filed Chapter 7 initially (and he argues that certain factors buttress this presumption); thus, the firm's services were really of questionable value and benefit to the Debtor and its creditors; much of the firm's time was devoted to the cash collateral issue, and this time was ill-spent in light of the fact that the lender had refused from the outset to consent to the use of cash collateral; and finally the firm's post-conversion services related to the filing of schedules and amendments thereto, a task which was largely undertaken by the Chapter 7 trustee and with regard to which the firm's services "were not critical." The United States Trustee makes other less broad-scale arguments with regard to the application.

The lender represents that the time entries in the application suggest that the firm was not only acting as bankruptcy

counsel for the Debtor but also as general counsel for the Debtor and as counsel for the Debtor's financial consultants. It requests that the firm only be awarded compensation with respect to its role in representing the Debtor with regard to bankruptcy matters. It cites some specific purported examples with regard to its argument.

The United States Trustee's objections may be seen to implicate one or both of two views expressed in the multitude of cases attempting to lend some guidance on the matter of fee allowances in bankruptcy.

One view is that fees for a Chapter 11 Debtor's attorney should be reduced or disallowed if the reorganization attempt appears to have been futile from the start and where the effort imposed a "heavy cost" on both the secured and unsecured creditors who would have benefitted from a prompt liquidation of the estate. *In re Combined Croft Corporation*, 58 B.R. 819 (Bkrtcy. W.D. Wis. 1986).[1] The other view, stemming from the United States Supreme Court's decision in a non-bankruptcy case entitled *Pennsylvania v. Delaware Valley Citizens Counsel for Clean Air* 478 U.S. 546, 92 L.Ed.2d 439, 106 S.Ct. 3088 (U.S. 1986), is that most of the twelve

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[1]To the Court's knowledge, the reorganization attempt here imposed a cost, ultimately, only on secured creditors. At the time the effort was undertaken it was thought that there was substantial equity in real estate: the post-petition discovery of asbestos on the premises substantially undermined anticipated values.

factors known as the "Johnson Factors"[2] for determining the reasonableness of Court awarded attorney's fees eventually fall away if the Court begins with a "lodestar" analysis. The Supreme Court explained "lodestar" as an approach whereby the Court first determines a reasonable number of hours for the work performed, then a reasonable hourly rate for such work, then multiplies the two to obtain a "lodestar" amount, then adjusts the amount upwards or downwards in light of statutory policies and purposes.

Thus in the case of *In re Jensen-Farley Pictures, Inc.* 47 B.R. 557 (Bkrtcy. D. Utah 1985), at p. 587, the Court stated that although one of the "Johnson Factors" is the "results obtained" by the attorneys, the Bankruptcy Reform Act of 1978 substituted "reasonableness," "actual," and "necessary" for "benefits conferred" as the test for fee allowances under the Code. It further stated that hours may be reasonably and necessarily spent, and therefore be compensable under 11 U.S.C. § 330, even though the effort did not result in a benefit to the estate. That Court

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[2]These were enunciated by the Fifth Circuit in the case of *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), a non-bankruptcy case. They are: (1) The time and labor required. (2) The novelty and difficulty of the questions. (3) The skill requisite to perform the legal service properly. (4) The preclusion of other employment by the attorney due to acceptance of the case. (5) The customary fee. (6) Whether the fee is fixed or contingent. (7) Time limitations imposed by the client or the circumstances. (8) The amount involved and the results obtained. (9) The experience, reputation, and ability of the attorneys. (10) The "undesirability" of the case. (11) The nature and length of the professional relationship with the client. (12) Awards in similar cases.

stated that a result-based analysis of fee requests under sections 330 and 331 should be applied primarily in cases in which "bonus" or "premium" fee is sought for "extraordinary results," and suggested that if a Court, in accordance with the "lodestar" approach sets a "reasonable" hourly fee for the services performed, and multiplies that fee by the number of hours that were "actual" and "necessary" there would be no reduction thereafter resulting from a lack of success.[3]

It would appear that under the first view the Court would disallow (or reduce the compensation allowed for) specific services that did not benefit the estate. Under the second view the Court would use Johnson Factors as the background against which to fix a reasonable hourly rate and a reasonable number of hours for the services rendered, and multiply the rate and hours in order to obtain a "lodestar" figure, which then might be adjusted upward or downward with regard to Johnson Factors not already subsumed in the first analysis, in order to serve the pertinent statutory purpose. (*See Pennsylvania v. Delaware Valley*, 92 L.Ed.2d 439 (U.S. 1986), at 456-457).

The results would likely be comparable regardless of the approach, in most instances. In this case in which the United

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[3]The *Jensen* case contains a comprehensive and thorough discussion of fee allowance practices in bankruptcy as of the year 1985.

States Trustee basically attacks the wisdom or necessity of overall strategies and efforts undertaken by the firm on behalf of the Debtor, the lodestar approach has the advantage of not requiring that the Court "itemize each motion, request or claim that has been presented ... and determine whether [the firm was] 'successful'." (*See Delaware Valley Citizens' Counsel v. Commonwealth of Pennsylvania*, 581 F.Supp. 1412 (E.D. Pa. 1984) at 1420.

My reading of the decision of the Supreme Court in *Pennsylvania v. Delaware Valley Citizens Counsel* is that the lodestar approach is valid in dealing with the 100 or more federal statutes providing for the award of attorney's fees, so long as any upward or downward adjustment from the lodestar amount is soundly based in the purpose of the particular statute at bar and so long as such adjustment is not made on the basis of a Johnson Factor that was already taken into account in determining the lodestar amount. Although I will return to the matter of the purpose of section 330 later, I will state it here to be that of abolishing the "economic spirit" of the Bankruptcy Act of 1898 and to permit "bankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously,"[4] to receive fees in bankruptcy cases that are comparable to those they could receive in other areas of specialized commercial practice.

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[4]House Report 95-595, 95th Congress, First Session, pages 329-330.

The objections of Anchor Savings Bank are likewise best assessed in the context of the lodestar approach. Chapter 11 debtors are of widely varying size. They range from major corporations with in-house counsel as well as outside counsel to handle their day to day, non-bankruptcy legal affairs, at one extreme, to one-person operations which have no legal representation at all other than "bankruptcy" counsel. Near the smaller end of the spectrum it may become impossible to draw the line between what bankruptcy counsel does for the client that is compensable at "bankruptcy specialist" rates as opposed to what it does that is not specific to a bankruptcy proceeding and perhaps should be compensated at a higher or lower rate. This situation is compounded further where, as here, the Debtor is involved in a business that is both heavily regulated and of great importance to the local community. Representation by specialists may well be extremely necessary at hearings or meetings with regulators and with the local creditors and residents concerned with what the Chapter 11 filing means to them. Moreover, consultations between bankruptcy specialists and regulatory specialists may be required. The lodestar approach provides a manageable way of addressing such circumstances.

Thus I will utilize the lodestar analysis. The first step is to determine reasonable hours, the second is to determine a reasonable hourly rate, and the third is to address the matter of upward or downward adjustments in light of statutory purpose and

policy.

The history of this case begs for a trifurcation of the time period addressed in the fee application. The first phase is the pre-filing stage (April 12, 1989 to April 19, 1989), the second is the Chapter 11 phase (April 20, 1989 to May 20, 1989) and the last is the post-conversion phase (May 21, 1989 to October 2, 1989, the last date covered by this fee application).

Phase 1. As indicated above, the firm seeks compensation for approximately thirty hours of time expended before the filing of the Chapter 11 Petition. This work was apparently performed by partners of the firm (a firm of 20-"something" lawyers). It involved conferences and telephone calls, as well as preparation of documents and legal research. The time sheets reflect attention to such matters as imminent action by Anchor Savings Bank, meetings with the Debtor's Board of Directors regarding the "probable" Chapter 11 filing, communications with the State Department of Health, actions addressing restraints on a bank account at Marine Midland Bank, and other typical pre-filing matters. It culminated in a 6.25 hour charge for meeting with the Debtor's Board to execute the Chapter 11 papers and discuss Chapter 11 rules of operation, cash collateral, mortgages, and other typical matters: matters which bankruptcy counsel would be remiss in not presenting to the management of the Debtor at the time of filing. I find that the 29.25 hours sought for this period appears to be "actual" and "necessary" and "reasonable."

Time for phase 1 was billed at an average rate of $153.50. Was this a reasonable lodestar hourly rate in light of pertinent Johnson Factors? For purposes of this phase and the others to follow I make the following Johnson Factor findings.

Although it would seem that no particularly novel bankruptcy questions were presented in this case, the case was of above average difficulty. This is because of the facts that: the Debtor was a hospital; the lender had adopted a non-cooperative stance from the beginning; and (as conceded by all parties, including the firm) the Debtor should have sought Chapter 11 relief six to twelve months earlier than it did. Consequently, the skill of specialists was required to perform the legal services properly.

The firm apparently does not have a large "stable" of bankruptcy specialists, and it may therefore be presumed that the acceptance of this employment did preclude the firm from other bankruptcy-related employment.

An hourly rate in excess of $125.00 was not "customary" in the firm's locale in 1989, but was not unprecedented.

The experience, reputation, and ability of the attorneys assigned to this case are unquestionably very high, but the results obtained for creditors were poor because of circumstances not related to the quality of representation.

Background circumstances, as well as events as they unfolded, posed very tight time limitations.

Apparently there had been no prior professional

relationship between the firm and its client. (The firm has not billed the estate for some consultation prior to April 12, 1989.)

The remaining Johnson Factors will be considered later in this decision.

To the extent that the objection of the United States Trustee may be viewed as questioning the wisdom of the decision to file the hospital in Chapter 11 as opposed to Chapter 7, and as to Anchor Savings Bank's objection that significant services performed by the firm for the Debtor were of the nature of "general counsel" rather than bankruptcy counsel, the firm has filed a Reply. The firm states that it was advisable to file a Chapter 11 rather than a Chapter 7 because continuing care for patients had to be insured, because the highest potential return to creditors would be from the operation or sale of an operating health care facility with patients in place, because the Debtor's real estate (appraised at the time in excess of $1 million) was almost entirely unencumbered, and because a study by the Debtor's accountants supported the view that the Debtor could be operated at at least a break-even level. The firm also emphasizes the health care and social issues surrounding this decision and specifically notes that the transition, ultimately to Chapter 7 was orderly and that no patient died (there were 30 patients at the time of filing).

As to services that were not specific to bankruptcy, the firm notes that these pertained to dealing with governmental health agencies and that specialized services in that regard were

absolutely necessary for the hospital to be reorganized or closed/liquidated in an orderly manner. The Court has examined the firm's application for approval of its retention as attorneys for the debtor-in-possession and discovers that the application enumerated the services to be performed and therein specifically recited "To represent applicant in connection with all general corporate and health care related matters and issues, including matters with any and all regulatory agencies." The order approving the application did not restrict retention to bankruptcy-specific matters only. Thus it may be said that the firm was retained not only as bankruptcy counsel but also as special counsel on health-care regulatory matters incident to bankruptcy.

The fee application discloses that bankruptcy-specific services were billed at $140.00 per hour and that services related to dealing with governmental health agencies were billed at $165.00 per hour. The partner who performed the bankruptcy-specific services is well known to the Court as being expert in such matters. The firm's reply statement provides impressive documentation of the expertise of the other partner with regard to matters involving regulation of the health care field, and represents that $165.00 per hour was the normal rate for partners with health care experience and expertise, at the time.

In light of all of the above findings as they apply to the period prior to (but incident to) the Chapter 11 filing, it is my determination that the rates billed by the firm were reasonable.

Both the time claimed and the rates reflected in the application being reasonable, the lodestar amount for that time period is the amount sought, $4,490.00. But I do find reason for downward adjustment.

Firstly is the matter of alleged duplication of services. The objectors point out that some services rendered by the two partners were duplicative. In this regard I note that some time is claimed for the services of one partner in consultation with the other partner. The amount of time so spent is not completely determinable, for in some instances it is not a separate time entry; rather the time entry reflects conferences with a number of persons outside the firm as well as conference with the other partner. In the contexts set forth in the application these consultations did not appear to be excessive in length; therefore I have not addressed them in the context of the question of whether the hours spent were reasonable. Moreover, a single firm has here been employed as both bankruptcy counsel and counsel to the Debtor in a specialized non-bankruptcy field. It is not inappropriate for the Court to allow compensation for consultation between the two specialists in the same firm. However, one of the "Johnson Factors" not yet addressed is the "nature" of the relationship between the Debtor and the firm. And as indicated above, allowances in excess of $125.00 per hour for bankruptcy counsel were not common in the pertinent locale at the time in question. In the firm's reply statement it states that the Debtor chose this

firm to represent it because this firm had "bankruptcy, health care and other expertise." If (and I am not saying that this occurred in this case) the rates agreed upon between the Debtor and counsel reflected any upward adjustment because of the availability of combined expertise in the single firm, then great care must be exercised in the award of fees for intra-firm consultations. In other words, if one retains a firm with combined expertise because of multiple needs, and pays a higher rate than normal because of the combined expertise, then billing for intra-firm consultations might be inappropriate.

As significantly in this case, it is essential to address a Johnson Factor not yet considered - "whether the fee is fixed or contingent." This factor is most often addressed in connection with the degree of risk undertaken by the attorney in accepting employment. Acceptance of employment as attorney for a debtor-in-possession is typically risky in two regards: (1) the amount to be allowed is subject to later determination by the Court, and (2) a source of funds from which to pay attorneys fees usually cannot be assured beyond any retainer. In this case, from the outset, only the first of the two risks seemed to apply because before the Chapter 11 filing the firm took a $30,000 mortgage on the real estate of the Debtor (which real estate appeared at the time to have massive value above encumbrances). It was understood that this mortgage would secure only such fees as would subsequently be allowed by this Court. (These circumstances were fully and clearly

disclosed in the original application for approval of the employment.) Although occurring in a fashion not contemplated at the time, there is in fact a secure fund from which to pay such fees as the Court allows here, not to exceed $30,000.00.

Given the dual nature of the firm's employment in this case, and the absence of risk regarding a source of funds for payment of these fees, I find that the statutory purpose of insuring the orderly and smooth administration of the bankruptcy system by attracting bankruptcy specialists to practice therein is adequately fulfilled by allowing only $125.00 per hour, rather than $140.00 per hour, for the services of the bankruptcy specialists.

It is important, indeed critical, to here disclaim that there is any "cap" on hourly rates allowable in cases assigned to me, and to disclaim any intention to reduce hourly rates when a secure fund exists for payment. The lodestar approach commands that I establish a reasonable hourly rate, for purposes of possible appellate review. I may not simply assess an overall reduction that has no demonstrable basis. I am here allowing all time claimed for intra-firm conferences and allowing in full all claimed compensation (at $165.00/hour, his normal rate) for the regulatory specialist. This fact combined with the secure fund for payment commands, in my view, a rate for the services of bankruptcy specialists that is not in excess of the prevailing rate for high-quality bankruptcy representation at the time in question.

Otherwise stated, when a single firm is retained as both

bankruptcy counsel and special counsel, and when a source of payment is secure, and when intra-firm consultations are billed-for and allowed, and when lodestar is the most appropriate method of addressing objections to the fee application, then the statutory purpose of attracting bankruptcy specialists to accept employment is fully met at the highest non-premium hourly rate.

Thus as to phase one, the lodestar of $4,490.00 will be reduced by $251.25, representing 16.75 times the $15.00 per hour reduction. $4,238.75 is allowed for the period April 12, 1989 through and including April 19, 1989.

For work performed on April 20, 1989 and thereafter until the end of the day on May 19, 1989, the firm seeks compensation for 88.5 hours devoted to this case. The nature of services performed during the period are typical of the early days of a significant Chapter 11 filing, particularly where there is no agreement as to the use of cash collateral. Only 10.5 of these hours are billed as to the health-care regulatory specialist. Thus it appears that 78 hours were devoted strictly to bankruptcy representation during this one-month period, some of which were performed by other staff of the firm and billed at associate rates, paralegal rates or clerical rates.

After examining the enumerated matters as well as the official case docket, I find the hours claimed to be "reasonable."

The firm seeks allowance of $12,505.00 for those hours, thus reflecting an average billing rate for that period of $141.30,

all things considered (including the work of the health-care regulatory specialist).

From the docket it appears that it became evident on May 8, 1989, that the effort to obtain approval of the use of cash collateral liened by Anchor Savings Bank would fail and that a conversion to Chapter 7 would occur. The time reflected on the fee application after that date, consequently, reflects attention to matters of "close-down," "patient relocation," and coordination with the United States Trustee, the incoming Chapter 7 Trustee, and others. Such activities are totally consistent with the statutory duties of a debtor even after it is evident that the case will be converted. The fact that the objectives in the case changed from attempting a successful reorganization to effecting an orderly transition to liquidation does not alter any of the pertinent lodestar elements. Consequently, as with phase one, the only adjustment will be that of a reduction in light of the dual nature of the employment and the lack of risk with regard to a source of payment. The 10.5 hours devoted by the health-care regulatory specialist will be allowed at the $165.00 per hour rate sought, totalling $1,732.50. The remaining $10,772.50 sought for this phase, constituting bankruptcy-specific work billed at an average rate of approximately $138.11, will be reduced by adjusting all bankruptcy-specialist time billed at a rate in excess of $125.00 per hour to that figure. Performing this analysis, it is seen that approximately 76 hours of phase two time was billed at a rate of

$140.00 per hour. Thus the amount sought for phase two ($12,505) for all employees of the firm is reduced by the amount of $1140.00. The total allowance to the firm for phase two is $11,365.00. For the post-conversion phase (May 22, 1989 through and including October 2, 1989) the firm seeks $3,837.50 for 29 hours of work devoted to the case. Most of this work involved the preparation of schedules, amendments to the schedules, preparation of the final report and account concerning operation as a debtor-in-possession, preparation and appearance at the section 341 meeting and communications with the Chapter 7 Trustee and with the offices of the Clerk and of the United States Trustee. Some of these services were performed by an attorney billed at $100.00 per hour.

The United States Trustee has objected to the application as it pertains to the post-conversion phase on the basis that schedules had not been timely filed in the case and that, consequently, the Chapter 7 Trustee "was forced to hire people and expend time in completing the schedules. Applicant's services, upon information and belief, were not critical in the formulation of the schedules." In response, the firm states that "a large amount of time was spent in preparing schedules but none of such time was wasted or insufficient; it was required due to the poor condition of the Debtor's books and records."

While the fact that the Debtor's books and records were in poor condition may explain the tardiness of schedules, it does not explain why significant amounts of a bankruptcy specialist's

attention was devoted thereto, particularly where, as here, a major accounting firm had been duly appointed to provide services to the Debtor including, in pertinent part, "those that would be performed by a full time administrator and full time chief financial officer." (See paragraph 6 of the April 28, 1989 application). Development of financial statements and ongoing accounting controls were specifically included within the "scope" of work to be performed. The accounting firm has not yet filed its application for fees; consequently, I cannot determine the extent of its involvement in the matter of preparation of schedules.

Nor do I intend at this time to conduct an evidentiary hearing into the matter of the relative contributions made by the attorneys, by the Chapter 7 Trustee and his employees, and by the accounting firm, in post-conversion matters such as the preparation of schedules. Such a hearing would merely increase expenses.

Subject to later reconsideration upon application by the firm, I rule at this time with regard to phase three that when all Johnson elements and lodestar elements are considered (including all bases for enhancement or reduction of the lodestar amount) a phase three award will be made in the amount of $1,500.00 representing 15 hours at an average hourly rate of $100.00.

Finally, there is the matter of reimbursement of costs and expenses. $1,501.32 is sought, $500.00 of which appears to be the filing fee for the chapter 11 petition. No objections have been filed with regard to costs. The costs appear to be reasonable

and will be allowed in full.

The fee application is allowed as follows: $17,103.75 for services, and $1501.00 for disbursements. The firm is granted leave to apply for reconsideration of the phase three allowance after the Court has fixed compensation for the trustee, attorney for the trustee and for accountants for the estate, but in no event will the Court make an award for phase three services that would exceed the amount that would be yielded upon application of the phase one and phase two analysis; this is to say that any "bankruptcy specialist" hours billed at rates in excess of $125.00 per hour would be reduced to that rate.

SO ORDERED.

Dated: Buffalo, New York
February 24, 1992

/S/ MICHAEL J. KAPLAN
U.S.B.J.