Retention Tension: Bankruptcy Court Approves Investment Bank Transaction Fees

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Ethical Issues Involving Disclosures and Retention
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In the relentless search for value for unsecured creditors in chapter 11 cases, parties in interest have increasingly looked to challenge professional fees, including the often sizable transaction fees sought by investment banks at the conclusion of a successful restructuring. The trend is fueled by the decisions in *Asarco* and its progeny, which require professionals to spend their own funds, not their clients', to resist attacks on their claims for compensation. One question that has arisen in the context of such challenges is the standard of review that the court should apply in deciding whether or not to permit the payment of requested fees, especially transaction fees by investment bankers. A recent decision by the Bankruptcy Court for the Southern District of New York in *In re Relativity Fashion LLC et al.,* 2016 Bankr. Lexis 517 (Bankr. S.D.N.Y., December 16, 2016) ("Relativity Fashion") has brought clarity to the standards that courts will apply in determining the approval of such fees. In *Relativity Fashion*, the bankruptcy court held that once an investment bank has been retained pursuant to section 328(a), a party's ability to object to the payment of fees will be limited to narrow exceptions contained in that section, and the party will not be able to object on the reasonableness grounds under section 330 of the Bankruptcy Code. The Court's ruling provides reassurance to investment bankers that terms of their retention will not be revisited on a post hoc basis, and serves as a reminder to other interested parties that the time to object to fee arrangements is at retention — not when the bill for services becomes due.

Background

Relativity Fashion LLC and its affiliated debtors ("Relativity") were a privately-held entertainment company that provided film and television financing, production and distribution. After a failed attempt to become a full service movie studio, Relativity entered bankruptcy in July of 2015. Shortly thereafter Relativity retained the services of two investments banks, PJT Partners LP ("PJT") and Houlihan Lokey Capital, Inc. ("Houlihan"), to assist in shepherding the debtors through separate aspects of the chapter 11 restructuring process.

Both PJT and Houlihan entered retention agreements with Relativity that provided for the payment of monthly fees plus a transaction fee that was to be paid if a transaction was consummated — a compensation structure that is common to most investment bank retentions both in and out of the chapter 11 context. After notice and a hearing, the bankruptcy court entered orders approving the investment banks' retention and clearly stated that the retention was approved under section 328(a) of the Bankruptcy Code. Additionally, the order approving PJT's retention also provided that the United States Trustee retained all rights to respond or object to

interim and final applications on all grounds, including reasonableness pursuant to Section 330 of the Bankruptcy Code, and that the court retained jurisdiction to consider any such objections by the United States Trustee on section 330 grounds. Similarly, the order approving the Houlihan retention also provided that the United States Trustee *and the unsecured creditors' committee* retained the right to challenge the reasonableness of the investment banks fee's on section 330 grounds. Following a successful auction of certain assets of the debtors and a restructuring of the remaining assets of the estate, PJT filed a final fee application seeking the approval of a $4.5 million transaction fee and Houlihan filed a fee application seeking approval of a $5 million transaction fee.

The Objections

The court appointed fee examiner (the "Fee Examiner") and Relativity Secured Lender, LLC ("RSL" and with the Fee Examiner, the "Objectors") objected to the investment banks fee applications on the grounds that the transaction fees were unreasonable under section 330 of the Bankruptcy Code (regardless of the fact that the investment banks had been retained pursuant to section 328(a)).[1] Additionally, as to PJT's, the Objector's argued that the investment bank had failed to meet the contractual conditions required for the Debtors' to be obligated to pay the requested transaction fee.

Although the Fee Examiner and RSL objected to the application, no other parties, included the U.S. Trustee or the unsecured creditors committee in the case, filed an objection to the investment banks fee requests.

Discussion

The allowance of the investment banks' fee requested turned on the interplay and difference between the standards set forth in section 328(a) and section 330 for the payment of professionals. Under section 328(a), a debtor can employ certain designated professionals to assist in the administration of the estate so long as the conditions of employment are reasonable and the employment request is pre-approved by the bankruptcy court.[2] Once the bankruptcy court approves the proposed compensation under this section and the hired professionals complete their engagement, a court generally may only modify the agreement "[i]f such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions."[3] As the bankruptcy Court noted in *Relativity*, "[e]ssentially, under Section 328(a), reasonableness is judged in advance, and the issue is not revisited except in the very narrow circumstances permitted by the statute."[4]

In contrast, under Section 330, a court reviews all "relevant" factors, including time spent, rates charged, whether services were necessary or beneficial at the time such services were rendered, whether the services were performed in a reasonable amount of time, and whether the compensation is reasonable based on customary compensation charged by comparably skilled

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1 The Objectors conceded that the investment banks requested transaction fees would be permissible if the Court were to apply the standards set forth in section 328(a).

2 11 U.S.C. 328(a)

3 *Id.*

4 *See Relativity* at *6.

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