IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
ENTERED
NOV 28 2001
TAWANA C. MARSHALL, CLERK
By _____
Deputy

IN RE:	§	
	§	
PRECEPT BUSINESS SERVICES, INC., et al.,	§	CASE NO. 01-31351-SAF-11 (Jointly Administered)
	§	
DEBTOR(S).	§	

MEMORANDUM OPINION AND ORDER

Murphy Noell Capital, L.L.C., investment bankers for Precept Business Services, Inc., et al., the debtors, in Chapter 11, has filed an application with the court for the final allowance of compensation and reimbursement of expenses. Murphy Noell requests the final allowance of $183,264.70 of post-petition fees and $10,029.24 of post-petition expenses, for a total of $193,293.94. Murphy Noell has already been paid $135,646.24. In addition to approval of its fees and expenses, Murphy Noell requests that the court direct the payment of the balance of $57,647.70. Bank One, NA, and Wells Fargo Bank (Texas), National Association, oppose the application. The banks contend that compensation for Murphy Noell should not exceed $100,000.

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The court conducted an evidentiary hearing on the application on October 22, 2001. The determination of compensation and reimbursement of expenses for professional persons employed under §327 of the Bankruptcy Code constitutes a core matter over which this court has jurisdiction to enter a final order. 28 U.S.C. §§157(b)(2)(A), (O), and 1334. This memorandum opinion contains the court's findings of fact and conclusions of law. Bankruptcy Rules 7052 and 9014.

Customarily, the court determines reasonable compensation for professional persons compensated by a bankruptcy estate under a lodestar analysis, assessing the reasonable number of hours worked on a project times a reasonable hourly rate. Hensley v. Eckerhart, 461 U.S. 424, 434 (1983). However, Murphy Noell does not request compensation based on an hourly rate. Instead, Murphy Noell calculates its compensation based on a percentage formula. Murphy Noell has no time records and cannot establish how much time it worked on its engagement with the debtors post-petition.

Murphy Noell attached a letter agreement to the debtors' application for authorization to employ the investment banking firm. The letter agreement provided that Murphy Noell would be paid a base fee of 2.35% of the cash proceeds received by the debtors in connection with a sale of any of its companies or

operations up to an aggregate amount of $3.2 million, with an incentive fee of 5% of any cash proceeds received above $3.2 million. In addition, Murphy Noell would be reimbursed for all reasonable expenses incurred in the performance of its duties to the debtors, not to exceed $7,500 without prior written consent of the debtor.

In its application for authorization to employ Murphy Noell, the debtors recited this proposed compensation scheme. The application recites that Murphy Noell will file a final fee application under 11 U.S.C. §330. The application states: "Murphy Noell's compensation will depend, among other things, on the quality of its work and the benefit to the estate of the services provided by Murphy Noell. Murphy Noell has agreed to be compensated in accordance with 11 U.S.C. §§328, 330 and 331." The debtor further stated that it "wishes to employ Murphy Noell to perform the necessary services described above pursuant to 11 U.S.C. §§328, 330, 331, 1107 and 1108 of the Bankruptcy Code."

On April 12, 2001, the court entered an order authorizing the employment of Murphy Noell as investment bankers for the debtors. The order recites

> . . .that for its services, the Debtors shall pay Murphy Noell a base fee of 2.35 percent of the cash proceeds received by the Debtors up to an aggregate amount of $3.2 million, in conjunction with the sale of companies or operations that take place after the

> Effective Date of Murphy Noell's retention; . . . [and] that the Debtors shall pay Murphy Noell five percent (5%) of any cash proceeds received by the Debtors in excess of $3.2 million, in conjunction with the sale of companies or operations that take place after the Effective Date of Murphy Noell's retention; . . . [and] Murphy Noell shall be reimbursed by the Debtors for reasonable expenses incurred in the course of providing services to the Debtors, subject to the $7,500 limit set forth in the Application.

The order directs that any application for compensation by Murphy Noell "shall be subject to this Court's review and approval pursuant to the standards described in section 330(a) of the Bankruptcy Code."

Citing the last provision of the retention order, the banks contend that the court should review the application based on the lodestar standards customarily applied by federal courts under §330. The court would determine the number of hours reasonably expended by considering the factors enumerated in the statute and the reasonable hourly rates by considering the prevailing rates in the community for similarly qualified and experienced professional persons. Missouri v. Jenkins, 491 U.S. 274, 286 (1989); Blum v. Stenson, 465 U.S. 886, 895 (1984). The court would then adjust the compensation based on the Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 (5th Cir. 1974), factors. Blanchard v. Bergeron, 489 U.S. 87, 91-92, 94-95 (1989). The Johnson factors may be relevant for adjusting the

lodestar calculation but no one factor can substitute for the lodestar. Id. at 94. Rather, the lodestar shall be presumed to establish a reasonable fee with adjustments made when required by specific evidence. Pennsylvania v. Delaware Valley Citizens Council for Clean Air, 478 U.S. 546, 563-65 (1986). Under the lodestar approach, the applicant has the burden of proof to establish the reasonableness of compensation. The applicant must show that its requested compensation is reasonable, was necessary for the proper administration of the bankruptcy estate, and provided a benefit to the estate. Matter of Pro-Snax Distribs., Inc., 157 F.3d 414, 426 (5th Cir. 1998).

The Fifth Circuit has previously explained that the lodestar method of determining fees traditionally applies to the award of compensation pursuant to federal statute. Consequently, for example, even if an attorney has been retained to be compensated on a contingency fee arrangement, the attorney must establish the reasonableness of the fee. See Brown v. Sullivan, 917 F.2d 189, 192 (5th Cir. 1990).

But, Murphy Noell contends that the court authorized its employment under 11 U.S.C. §328(a). That section provides:

> The trustee, . . .with the court's approval, may employ . . .a professional person under section 327 . . . of this title . . . on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis. Notwithstanding

> such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C. §328(a). Murphy Noell argues that because the court adopted the terms of the compensation scheme, the employment order amounts to an order approving the terms and conditions of employment under §328(a).

The employment order provides the compensation scheme for Murphy Noell. The United States Court of Appeals for the Fifth Circuit has decided that "[i]f prior approval is given to a certain compensation, §328 controls and the court starts with that approved compensation, modifying it only for developments unforeseen when originally approved." In the Matter of National Gypsum Co., 123 F.3d 861, 862 (5th Cir. 1997). Thus, even though the employment order describes an obligation to apply for compensation under §330, the court must construe the order as approving terms and conditions of employment under §328(a).

In National Gypsum, the bankruptcy court authorized the employment of investment bankers upon the terms and conditions of an engagement letter. But, the court expressly retained the right to consider and approve the reasonableness of the investment bankers' fees on a final basis. That express

reservation followed the investment bankers' retention hearing, where the court stated on the record that the court was authorizing the retention of the investment bankers under 11 U.S.C. §327, but not approving the contract under 11 U.S.C. §328(a). See proceeding memorandum dated May 29, 1991, In the Matter of National Gypsum Company, case no. 390-37213-SAF-11, Bankr., N.D. Tex. That express action notwithstanding, the Fifth Circuit directed that the retention order amounted to an order under §328(a).

By so holding, the Fifth Circuit has made a significant public policy decision. Matter of Texas Securities, Inc., 218 F.3d 443, 446-48 (5th Cir. 2000)(Garza, R., J. dissenting). This court required applications under §330 for compensation while acknowledging the requested compensation scheme of a professional person not paid on an hourly basis. By so doing, this court, like other bankruptcy courts, recognized that the professional person may request compensation based on that scheme, but nevertheless required that, at the end of the employment, the professional person establish the reasonableness of that compensation. As with any other person seeking the payment of an administrative expense from a bankruptcy estate, the professional person would have to establish the benefits to the estate realized by the services rendered. See In re Harbor Fin. Group,

Inc., 2001 U.S. Dist. LEXIS 14412, 7-8 (N.D. Tex. 2001). In practice, the professional person would have ethically exercised reasonable billing judgment and would have submitted to the typical market dynamics of discussing actual compensation with the executives of a debtor responsible for corporate decision-making before filing applications under §330.

The Fifth Circuit now instructs, however, that if the court recognizes the terms and conditions of compensation in a retention order, then the order must be construed to be an employment order under §328(a), rather than under §330(a). The decision shifts the standard and burden of proof from the professional person seeking payment of compensation from a bankruptcy estate, based on reasonableness and benefit to the estate, to the creditors of a bankruptcy estate to show that payment of compensation would be improvident. Matter of Texas Securities, Inc., 218 F.3d at 445-46; National Gypsum, 123 F.3d at 862-63. The Court based its decision on the Bankruptcy Code's policy to compensate professional persons in bankruptcy cases based on the prevailing markets. The Court recognized the Congressional concern to induce quality professional participation in bankruptcy cases. A perusal of professional compensation in bankruptcy cases would reveal that this policy has long been accomplished. The Circuit's stated concern in the

mid to late 1990s with pre-Code professional compensation in bankruptcy cases is like Alex Rodriguez expressing a concern with pre-free agency compensation of baseball players. See National Gypsum, 123 F.3d at 862. While this court, obviously, had concluded that absent an express, unambiguous order under §328(a), compensation should be determined under §330(a), the Circuit has mandated that orders with compensation schemes be construed under §328(a). Relief from that mandate must come from the Fifth Circuit.

This court has, however, adopted guidelines to eliminate uncertainty. The guidelines provide:

> If, in a Chapter 11 case, a professional to be employed pursuant to section 327 or 1103 of the Bankruptcy Code desires to have the terms of its compensation approved pursuant to section 328(a) of the Bankruptcy Code at the time of such professional's retention, then the application seeking such approval should so indicate and the Court will consider such request after an evidentiary hearing on notice to be held after the United States trustee has had an opportunity to form a statutory committee of creditors pursuant to section 1102 of the Bankruptcy Code and the debtor and such committee have had an opportunity to review and comment on such application. At a hearing to consider whether a professional's compensation arrangement should be approved pursuant to section 328(a), such professional should be prepared to produce evidence that the terms of compensation for which approval under section 328(a) is sought comply with the certification requirements [of the guidelines].

See General Order No. 00-7 (Bankr. N.D. Tex Dec. 21, 2000)(adopting Guidelines for Compensation and Expense

Reimbursement of Professionals, effective January 1, 2001).

Murphy Noell failed to fully comply with those guidelines. However, because the employment authorization order adopts the compensation scheme of the retention letter, the application for compensation must be reviewed under §328(a).

Nevertheless, the banks argue that Murphy Noell failed to perform its functions, that the bankruptcy estate could not have foreseen that Murphy Noell would not perform, and that, as a result, payment of compensation based on the commission schedule would be improvident. Murphy Noell counters that it performed all the tasks requested by the debtors.

The court starts its analysis with the compensation calculation based on the terms stated in the order authorizing employment. Texas Securities, 218 F.3d at 445. The court may modify that calculation if it finds that the original arrangement was improvident due to unanticipated circumstances; circumstances unforeseen when the compensation scheme was originally approved. Id.; National Gypsum, 123 F.3d at 862. The compensation scheme must prove to be improvident in light of developments not capable of being anticipated at the time of the fixing of the terms and conditions of compensation. 11 U.S.C. §328(a); Matter of Barron, 225 F.3d 583, 586 (5th Cir. 2000). Thus, it is not enough that

the developments were simply unforeseen. Matter of Barron, 225 F.3d at 586.

Murphy Noell performed considerable functions for the debtors pre-petition. Murphy Noell gathered, packaged, and delivered the debtors' financial data to prospective purchasers and investors. Murphy Noell developed a business valuation template to use in the marketing and sales of the debtors, their assets, and business units. Murphy Noell also identified prospective purchasers pre-petition. Additionally, Murphy Noell assisted in the closing of two sales. Murphy Noell also advised the debtors to retain a turnaround specialist. The debtors paid Murphy Noell compensation of $270,700 and reimbursement of expenses of $55,582, for this pre-petition work.

The banks had also advised the debtors to retain a turnaround specialist. The debtors retained Lee Hassell. Hassell and the banks agreed that Murphy Noell should be retained post-petition to facilitate a quick and efficient liquidation of the debtors' remaining business units. Because of the significant pre-petition services rendered by Murphy Noell, Hassell requested that Murphy Noell prepare "an action plan which will describe the duties and the tasks for which Murphy Noell will be responsible in attempting to sell components of the Business Products Division and Transportation Services Division

as going concerns." Debtors' App. For Order Authorizing the Employment of Murphy Noell, par. 10. Murphy Noell agreed to provide that action plan. Hassell testified that he expected Murphy Noell to comply with that requirement. Ronald Christenson of Wells Fargo Bank also testified that he expected Murphy Noell to provide the action plan. In expectation of understanding Murphy Noell's post-petition duties and tasks, and with an eye towards the quick sale of the debtors' remaining business units, the banks had authorized the debtors to spend up to $158,000 of their cash collateral for Murphy Noell's services.

Murphy Noell did not provide the debtors with the action plan. Craig Noell testified that certain documents and communications could be construed as an action plan. However, that belated effort to cobble together a plan does not substitute for the action plan required by Murphy Noell's post-petition employment application. Murphy Noell failed to provide the action plan. Consequently Murphy Noell failed to perform one of its required tasks, a crucial task indeed because it would have defined Murphy Noell's post-petition duties and tasks. Neither the debtors, the banks nor the court had any reason to foresee at the time of the entry of the court's employment order that Murphy Noell would fail to perform this function. The compensation scheme requires the performance of assigned tasks. Murphy Noell

thereby failed to earn a portion of compensation. The court, therefore, concludes that it would be improvident to pay Murphy Noell as if it performed all its functions.

Noell anticipated a $42 million workout but instead dealt with a $5 million post-petition package of assets. Noell testified that post-petition, the Precept assignment constituted "nuisance" work for his firm. According to Hassell's and Christenson's testimony, Murphy Noell's post-petition work reflected that attitude.

Hassell testified that he lost confidence in Murphy Noell. Hassell expressed to Murphy Noell dissatisfaction with their responsiveness. Noell became emotional in discussions with Hassell, when Hassell looked for calm from his investment bankers. Consequently, Hassell turned to the debtors' attorneys to perform work that would otherwise have been performed by Murphy Noell in bringing transactions to closings.

Christenson felt that Murphy Noell basically disappeared post-petition. Christenson testified that Hassell and the debtors' attorneys performed the bulk of the post-petition work that brought the transactions to closings. The court asked Christenson if the banks expected to pay a commission if the sales closed. Christenson said the banks would expect to pay a commission, but, in return, would expect the broker, in the case

of a real estate sale, to perform the tasks necessary to complete the closing process. Christenson testified that Murphy Noell did not so perform.

Murphy Noell's attitude, the resulting dissatisfaction by the debtor with its services, and the performance of services by the debtors' attorneys that should have been performed by Murphy Noell, could not have been foreseen at the time of the fixing of the terms and conditions of compensation. Neither Hassell nor the banks had a basis to believe that the investment bankers would view the post-petition work as a "nuisance" to their firm. In light of these developments, the banks have established that it would be improvident to compensate Murphy Noell as if it had fully performed its tasks.

With the finding of improvident, the court determines compensation based on a reasonableness standard under §330(a). Texas Securities, 218 F.3d at 445-46. The court's guidelines for professional compensation require that all professionals, except auctioneers, real estate brokers and appraisers, keep accurate contemporaneous time records. Murphy Noell did not keep any time records. Noell suggested offhandedly that his firm spent 1,000 hours on the Precept assignment. However, he has no records to substantiate that number. He also failed to review his firm's activities to determine the time spent on this engagement post-

petition. Consequently, Murphy Noell has no credible evidence of time spent on the engagement.

The court's guidelines also require project billing. That guideline enables the court to assess compensation based on the projects performed. Murphy Noell's fee application recites that the firm maintained project billing, referring the court to exhibit B to the application. Exhibit B reflects the three categories of sales post-petition, with Murphy Noell's fee calculation and a listing of activities. It does not reflect the time spent on these sales. Noell conceded that the general descriptions cover pre-petition work, as well as post-petition work.

With respect to the transportation business sales, Murphy Noell worked with Republic Car Services, Inc., to facilitate that sale. Murphy Noell also handled informational mailings for the transportation business. The firm appeared at the hearing as expert witnesses to support the debtors' sales motion. Noell testified about the transportation business sales. Hassell and Christenson agreed that Murphy Noell performed these compensable services. Based on exhibit B to the application, Murphy Noell's base fee for the transportation related sales totals $62,040 ($11,045 for the May 8, 2001, sale and $50,995 for the June 5, 2001).

Murphy Noell also appeared as an expert witness at two other hearings on the debtors' sale motions. Hassell recognized that although he negotiated the final agreements with the post-petition buyers, the sales process had been a fluid process beginning pre-petition, with Murphy Noell having contacted prospective buyers pre-petition. In recognition of this work, the banks suggest that Murphy Noell should be compensated a total of $100,000.

By awarding the base fee for the transportation sales, the court recognizes that fluidity, and compensates Murphy Noell for the post-petition work of negotiating with Republic, doing some mailing, and for its availability as expert witness. However, the court does not include a fee calculation greater than the base fee for those transactions to recognize and counterbalance the work of Hassell, the bankruptcy estates' lawyers, and the banks to complete the transactions. By accepting the banks suggested compensation, the court compensates Murphy Noell for its time as expert witnesses for the other sales and the fluidity of the process.

The record does not contain evidence to support any greater compensation. Murphy Noell neither established time spent on the projects post-petition nor established time spent by any of its people on the Precept assignment post-petition. Hassell and the

attorneys had to complete negotiations. Noell treated the post-petition work as a "nuisance" to his firm. Murphy Noell never defined its post-petition tasks and duties in the required action plan, thereby depriving the court and the parties in interest of a means to assess the performance of its work. In the employment application, Murphy Noell agreed that its compensation must be valued by the quality of its work and the benefit to the estate. Having found the compensation scheme to be improvident under §328, Murphy Noell has not established a record to support compensation greater than $100,000.

On this record, the court finds reasonable compensation to be $100,000.

Murphy Noell also requests reimbursement of expenses of $10,029. The employment order directs "that Murphy Noell shall be reimbursed by the Debtors for reasonable expenses incurred in the course of providing services to the Debtors, subject to the $7,500 limit set forth in the Application." The application states that Murphy Noell will not be reimbursed above $7,500 "without prior written consent by the Debtors."

Murphy Noell never requested prior written consent from the debtors for its expenses above $7,500. Noell testified that the expenses covered trips to Dallas at the debtors' requests to be available to testify at hearings. Murphy Noell invoiced the

debtors for these expenses and the debtors paid the invoices. Murphy Noell contends that its submission of the invoices substantively complies with its contractual agreement and the court order.

The banks strenuously disagree. The banks assert that without the prior written request, Murphy Noell contractually agreed not to be reimbursed above $7,500, and the court so ordered. The court agrees with the banks. The court order limited reimbursement of expenses to $7,500 as set forth in the application. Thus, as a prerequisite to even approaching the court to direct the bankruptcy estate to expend a greater sum, Murphy Noell had to comply with its contractual agreement with the debtors. Murphy Noell failed to do so. Accordingly, it may not be reimbursed above $7,500.

The court finds Murphy Noell's approach to this court and this application puzzling. Murphy Noell would hold the bankruptcy estate to the compensation scheme which was included in the court's order, but would otherwise pick and choose which provisions of the court's order and the employment application it would follow. Murphy Noell would also pick and choose which of the court's compensation guidelines, adopted by standing order of this court and applicable to this case, it would follow. The court cannot countenance that attitude and practice. Never-

theless, the court finds that $100,000 constitutes reasonable compensation and $7,500 constitutes the expense reimbursement standard.

As Murphy Noell has been paid $135,646.24 on an interim basis, Murphy Noell shall disgorge to the Chapter 7 trustee $28,146.24.

Based on the foregoing,

IT IS ORDERED that Murphy Noell Capital, L.L.C., is awarded final compensation of $100,000 and reimbursement of expenses of $7,500.

IT IS FURTHER ORDERED that Murphy Noell Capital, L.L.C., shall pay to Steve Turoff, the Chapter 7 trustee of the bankruptcy estates, the sum of $28,146.24.

Signed this 27th day of November, 2001.

Steven A. Felsenthal
United States Bankruptcy Judge