

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

IN RE: *

MERRY-GO-ROUND ENTERPRISES, INC. * Case No. 94-5-0161-SD

Debtor * Chapter 7

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**TRUSTEE’S MEMORANDUM OF LAW IN SUPPORT OF THE EIGHTH
AND FINAL APPLICATION FOR ALLOWANCE OF COMPENSATION**

Deborah Hunt Devan (the “Trustee”), Chapter 7 Trustee of Merry-Go-Round Enterprises, Inc. (“MGRE”) and its affiliated companies (collectively, with MGRE, the “Debtors” or “Merry-Go-Round”), files this memorandum of law in support of her Eighth and Final Application for Allowance of Compensation (the “Application”). The Application is also supported by the Declaration of Deborah Hunt Devan (the “Devan Declaration”), and the Declaration of Professor Geoffrey C. Hazard, Jr. (the “Hazard Declaration”), that are attached hereto as Exhibits 1 and 2.

In the Application, the Trustee is requesting final allowance of \$8,835,000 as “reasonable” compensation. Based on the disbursements to creditors, the amount requested is the full percentage commission allowable under section 326(a) of the Bankruptcy Code. Under Section 330(a), an award of compensation to a Chapter 7 trustee must be reasonable and is left to the discretion of the court.

Bankruptcy courts have taken different approaches in determining the reasonableness of final trustee compensation. Some courts look to the facts of the case and determine a reasonable award based on the nature, extent and value of the trustee’s services. This approach provides the court with a great deal of discretion in determining reasonable trustee compensation. Other

courts take a more formulaic approach and determine reasonable trustee compensation using the so-called *Johnson* factors and the trustee's award is determined by multiplying a reasonable rate times the number of hours worked. That "lodestar" is then increased by an enhancement multiplier if the circumstances warrant. The two approaches are similar, in that they each involve looking to the unique facts and circumstances of the case to determine what is reasonable compensation.

Whether the Court exercises discretion to determine reasonableness, or instead, analyzes reasonableness under a more formulaic lodestar analysis, the compensation requested by the Trustee in the Application is reasonable under Section 330(a) and should be approved. The Trustee achieved extraordinary results in this case and maximized the value of the estate for the estate's creditors. Moreover, no creditor opposes the Trustee's requested compensation.

The enactment by Congress in 2005 of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("2005 Act") has rejected the lodestar approach to trustee compensation and has substituted in its place a percentage-based approach. While the provisions of the 2005 Act do not apply to the Merry-Go-Round case, the 2005 Act is a directive from Congress that trustees should receive incentive based compensation in cases to which it applies. They should receive incentive based compensation, instead of lodestar based compensation, because they are not doing the same job as other professionals, and because it has been shown time after time that incentive based compensation is the best method available to insure that creditors receive the largest return. Incentive based compensation has the additional feature that trustees who do not achieve results for creditors will receive nominal compensation despite the amount of the lodestar of their actual time expended. Whether the Court employs an adjusted lodestar methodology, with hourly rate enhancements and multiples based upon extraordinary success, or

an incentive based percentage methodology, the end result is to determine what is reasonable compensation based on the success of the case, using subjective as well as objective factors.

Applying this flexible standard, the compensation sought in the Application is reasonable and well within the Court's discretion, based not only on the Trustee's extraordinary success in maximizing the estate's value, but also on the support of the estate's creditors.¹ The requested compensation also is consistent with the compensation awarded to trustees in other cases.

The Trustee has filed both the Application and the Declaration (at the request of the United States Trustee) which together contain evidence to support the requested compensation under an adjusted lodestar analysis. As of August 31, 2005, the Trustee worked 9,891.7 hours performing trustee services for the estate. The record of compensation awards to the Chapter 11 professionals in this case evidence that a reasonable rate for these services is no less than \$400 per hour, for a minimum lodestar of \$3,956,680. The Trustee also is submitting the expert declaration of Professor Geoffrey C. Hazard, Jr., who states that, assuming a \$400 per hour rate, an enhancement multiplier of 2.5 to 3.0 is appropriate in this case. This results in an adjusted lodestar in excess of \$9.8 million, more than the amount of compensation sought. Professor Hazard bases his opinion on factors such as the exceptional results obtained in this case and the difficulty and complexity of the issues involved. The proposed lodestar hourly rate and enhancement multiplier also are consistent with the case law, as discussed below.

STATUTORY AUTHORITY

This case was commenced in January, 1994. At that time the relevant statutory authority governing trustee compensation was the version of Section 326 which reads as follows:

¹ No creditors have filed an objection to the Application and the objection deadline passed on October 31, 2005. However, the Office of the United States Trustee indicated that it might object to the Application. By agreement, the Trustee extended the objection deadline for the Office of the United States Trustee only.

In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title to the trustee for the trustee's services, payable after the trustee renders such services, not to exceed fifteen percent on the first \$1,000 or less, six percent on any amount in excess of \$1,000 but not in excess of \$3,000, and three percent on any amount in excess of \$3,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims.

11 U.S.C. § 326

Section 330 at that time provided in relevant part as follows:

(a) After notice to any parties in interest and to the United States trustee and a hearing, and subject to sections 326, 328, and 329 of this title, the court may award to a trustee, to an examiner, to a professional person employed under section 327 or 1103 of the title, or to the debtor's attorney-

(1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney, as the case may be, and by any paraprofessional persons, employed by such trustee, professional person, or attorney, as the case may be, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title; and

(2) reimbursement for actual, necessary expenses.

11 U.S.C. § 330

The enactment by Congress in 2005 of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("2005 Act") amended Section 330 as it relates to trustee compensation. No longer will a trustee's compensation be based on lodestar. Instead new subsection (a)(7) states, "In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326." Clearly, Congress has rejected the lodestar approach to trustee compensation and has substituted in its place a percentage-based approach.

I. THE TRUSTEE’S ACCOMPLISHMENTS RESULTED FROM NOVEL, CUTTING EDGE THEORIES WHOSE IMPACT FAR EXCEED THIS CASE AND JUSTIFY THE MAXIMUM COMMISSION ALLOWABLE UNDER THE BANKRUPTCY CODE.

The issue here is simple – if the requested maximum commission is not reasonable in this case, taking into account the Trustee’s rigorous efforts, extraordinary results, novel theories (impacting not only this case but the entire restructuring profession) and the personal and professional risk she took upon herself, then when would a maximum commission be reasonable? It cannot and should not be the case that a maximum commission should only be awarded when the lodestar hours exceed the Section 326 cap. If that were true then it would nullify the stated clear intention of Congress in the 2005 Act (and in portions of the Legislative History of the Bankruptcy Code) to provide incentives to a trustee. When you examine the Trustee’s tremendous accomplishments in this case, it becomes clear that this is not only one of the most successful Chapter 7 cases in this District, but also one of the most successful, groundbreaking Chapter 7 cases ever pursued. In how many cases has a trustee *successfully*:

- Turned an administratively insolvent estate into a \$294 million estate with 100% payouts to administrative and priority claimants and an expected 40% payout to general unsecured creditors?
- Turned a failed restructuring into a successful Chapter 7 case by stabilizing the debtor’s business operations and putting the stalled going-out-of-business inventory sales (collectively, the “GOB Sale”) back on track, all within days of appointment and while facing an expected contested trustee election, and ultimately generating a recovery from traditional non-litigation assets in excess of \$90 million?

- Pursued an unpopular, untried claim against fellow insolvency professionals (thereby jeopardizing her own practice and source of referrals) and recovered a substantial settlement and industry-altering result, all at no risk and no out-of-pocket expense to the estate?

To accomplish one of these results in a case is exceptional. To accomplish all of these results in one case is phenomenal. That, plus much more, is what the Trustee did here.

At the time of the Trustee's appointment, the Debtors were struggling and in disarray. Expectations for creditor recoveries were bleak. Administrative and priority claimants were hoping for some small recovery, while general unsecured creditors were clearly out of the money. The GOB Sale had stalled due to bickering between the Debtors and the liquidators and was unsuccessful.

As soon as the Trustee took over, the landscape dramatically changed. The Trustee took control of the case and through tireless efforts and novel theories, she generated enough cash to provide a significant dividend to unsecured creditors. She increased the cash of the estate nearly 150-fold, from about \$2 million on the date of her appointment to approximately \$294 million today. Administrative claimants and priority claimants (mostly employees), who were hoping for a fraction of their allowed claims, will be paid in full. The general unsecured creditors, who at the time of conversion had no hopes for any recovery,² will now be paid roughly 40% of their allowed claims.

This estate was not found -- it was *created* through hard work, ingenuity and persistence. Upon her appointment, the Trustee stabilized the administration of the case through effective,

² When the case converted from Chapter 11, the Court was told by one attorney that it would take a "minor miracle" for the unsecured creditors to see any distribution in this case. (*See* Transcript of March 1, 1996 hearing, Dkt. 4584, at pp. 171-172).

creative and groundbreaking strategies. She took control of the GOB Sale, and through innovative approaches to realizing recoveries from the non-litigation assets, reaped in excess of \$90 million for the estate. She encountered numerous obstacles and problems in the process, all of which she was able to overcome. She also vigorously pursued objections to unsupported claims, which led to a 65% reduction in the amount of overall filed claims.

Most significantly, however, the Trustee investigated, developed and pursued the groundbreaking (yet unpopular) litigation against Ernst & Young (“E&Y”). The Trustee’s legal strategy of attacking the “bait and switch” staffing of professionals by E&Y was untried and unpopular. As such, it was unpredictable and exposed the Trustee to substantial personal risks. She could pursue the litigation, working days and nights for years, and if unsuccessful, would have nothing to show for it. Moreover, by turning against a major player in the insolvency field, the Trustee put into jeopardy her own professional standing and source of referrals. Indeed, the Trustee has not had a single referral of business from a national accounting firm since she sued E&Y, and even today trustees, debtors and committees are reluctant to pursue claims like these. The Trustee’s unselfish pursuit of this claim led to a substantial dividend for estate’s creditors. The E&Y litigation also turned Merry-Go-Round into a household name for those in the restructuring community.

The Trustee’s huge success in the E&Y case shook the restructuring industry and had significant ramifications well beyond Merry-Go-Round. The Trustee took on her own industry -- the “bankruptcy establishment” -- to pursue this groundbreaking litigation. Since then, many bankruptcy professionals, including other large accounting firms, have changed the way they staff cases and handle bankruptcy-related engagements. The Trustee’s success against E&Y did

more than just bring \$185 million to this estate, it also gained worldwide attention and brought about meaningful and substantive changes in how the restructuring industry operates.

The Trustee's pursuit of the E&Y claim was courageous and tenacious. For example, on the eve of trial, E&Y offered to settle the estate's claim for roughly \$100 million. Many trustees would have taken that offer for fear of being criticized if the recovery at trial was lower (or worse, nothing). The Trustee, however, knew her case inside and out and was ready to prove it at trial. Therefore, she was confident in demanding a larger amount and convinced E&Y that it would be unwise to call her bluff. After rejecting E&Y's \$100 million offer, the Trustee's resolve directly resulted in a huge gain for the estate – the case settled later that day for \$185 million.

The Trustee could have simply ignored the E&Y claim, as did the professionals employed in the Chapter 11 case. Such a decision could hardly be criticized because, until the settlement amount was announced, many parties did not view the E&Y claim as worth pursuing. Had she ignored the claim, the Trustee still would have turned an expected administratively insolvent case into a case with a 100% distribution to administrative and priority claimants and 20% percent distribution to general unsecured creditors. She also would have spared herself the significant professional risk of attacking one of the leading players in the insolvency world. Instead, she fulfilled her duty to the estate, pursued the E&Y claim and obtained sufficient funds to make a 40% distribution to unsecured creditors.

Based upon the Trustee's numerous accomplishments in this Chapter 7 case, the lodestar-enhancement analysis below, the clear Congressional intent in the 2005 Act to provide incentive-based compensation to trustees and the fact that no creditor opposes the Application, the Trustee's requested commission is reasonable under section 330(a) and should be approved. The

results in this case were truly exceptional. Awarding the requested amount will compensate the Trustee for her tireless efforts and personal sacrifices, and moreover, will advance the Congressional intent to encourage trustees to maximize the value of the estate for creditors. Simply put, the Trustee's accomplishment of maximum results in this case deserves the maximum compensation.

A. Congress Has Always Intended For Trustee Compensation To Be Incentive-Based.

Congressional intent to encourage trustees to maximize the estate with incentive-based compensation is apparent from reading section 330 in conjunction with sections 326 and 328, and is confirmed by the long-standing pre-Code practice, the 1994 amendments to section 326, and the 2005 Act.

1. The Legislative History and Amendments to the Bankruptcy Code Demonstrate a Congressional Intent That Trustees Should be Awarded Compensation that is Be Incentive-Based.

Under the former Bankruptcy Act, as under the current Bankruptcy Code, maximum trustee compensation was determined as a percentage of “all moneys disbursed or turned over by them to any persons, including lienholders.”³ 11 U.S.C. §76(c) (former Bankruptcy Act §48(c)). The Bankruptcy Act provided that a trustee could receive a discretionary \$150 fee irrespective of whether that amount exceeded the percentage-based cap. *See* H.R. Rep. 95-595 at 93, 1978 U.S.C.C.A.N. 5963, 6054-55. Congress eliminated the \$150 fee under the Bankruptcy Code. The legislative history provides that the \$150 fee was eliminated because it defeated the “original design” of the percentage fee system, which is “to induce trustees to find assets.” *Id.* .

³ In addition, similar to section 330(a) of the Bankruptcy Code, Bankruptcy Rule 219 (adopted in 1973) required the court to award “reasonable” compensation to trustees, and in doing so, to consider, among other things, the nature, extent, and value of the services rendered. Therefore, the reasonableness standard and the percentage-based cap for trustee compensation both pre-date the Bankruptcy Code.

Thus, Congress eliminated this \$150 fee under the Bankruptcy Code to preserve the pure incentive-based nature of trustee compensation. *Id.*

In enacting sections 326 and 330 of the Bankruptcy Code, Congress continued the policy that trustees should have incentive compensation. Congress stated in the 1978 legislative history to the Bankruptcy Code that: “[i]n order to provide an *incentive* to trustees to collect assets for the estate, trustees are compensated out of money of the estate.” *Id.* (emphasis added). Congress also supported incentive trustee compensation in the 1994 amendments to the Bankruptcy Code when it increased the percentages used to calculate the maximum trustee compensation under section 326(a). Tellingly, the title of this section of the 1994 law is “Increased *incentive* compensation for trustees.” PL 103-394, October 22, 1994, 108 Stat 4106, §107 (emphasis added). If Congress had not wanted to give trustees some incentive based compensation, it would have used a different title for the section.

Finally, under 2005 Act, Congress amended section 330(a) to provide that,

“[i]n determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326.”

11 U.S.C. §330(a)(7) (2005).

Although this amendment does not apply here, this statute is clarifying the intent of Congress and has overruled the case law under the Bankruptcy Code that used Section 326 only as a cap on trustee compensation. Instead, Congress directs the courts that trustee compensation is to be incentive based. The 2005 Act is crystal clear that factors such as time spent and the trustee’s normal hourly rate for performing legal services have little (and, perhaps, no) relevancy in determining reasonable compensation. In doing so, Congress has implicitly overruled the

decisions of the Third and Tenth Circuit Courts of Appeal which had held that the sole function of Section 326 was to cap the amount of lodestar compensation that could be awarded.⁴

A Chapter 7 trustee's primary duty is to maximize the value of the estate for its creditors. *See Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 352 (1985). This requires a trustee to have a stake in the results of her efforts so that her interests are always aligned with those of the estate's creditors. Accordingly, when determining reasonable compensation under an incentive-based system, one of the most important factors in the Court's analysis should be the benefit of the trustee's services to the estate.

2. The Different Duties of Trustees and Professionals Under the Bankruptcy Code Evidences a Congressional Intent to Provide Different and Incentive-Based Compensation to Trustees.

Some bankruptcy professionals are hired to perform needed tasks. Their compensation is designed to encourage them faithfully to perform those tasks. Thus, the Bankruptcy Code provides for their compensation entirely on a "lodestar" approach (*i.e.*, reasonable hours times reasonable rate) that pays them for the time they spend performing necessary tasks. Examples of these professionals include most attorneys and accountants.

Other professionals are hired to achieve results. Their compensation is incentive-based to encourage them to achieve the desired results. Examples here include auctioneers and brokers. Auctioneers and brokers are permitted to have their compensation pre-approved by the bankruptcy court under section 328 of the Bankruptcy Code.

Section 328 of the Bankruptcy Code (titled "Limitation on compensation of professional persons") states in pertinent part that a professional may be retained "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee

⁴ See, *In re Lan Assoc. XI, L.P.*, 192 F.3d 109 (3rd Cir 1999) and *In re Miniscribe Corporation*, 309 F.3d 1234 (10th Cir. 2002).

basis.” 11 U.S.C. §328(a). The Court determines the reasonableness of the terms and conditions in advance of the provision of services and at the time of employment. If the Court “pre-approves” a professional’s employment terms under section 328, then it *must* award compensation according to those terms unless they “prove to have been improvident in light of developments not capable of being anticipated at the time the terms were fixed.” *Id.* If there are no unanticipated developments, then the Court does not conduct a second reasonableness inquiry under section 330(a) at the time payment is sought. *See In re Merry-Go-Round Enterprises, Inc.*, 244 B.R. 327 (Bankr. D. Md 2000); *In re Benassi*, 72 B.R. 44, 47 (D. Minn. 1987) (“Section 330(a)(1) does not supplant §328(a) and give the judge free reign to void a previously authorized employment agreement for a percentage fee.”).

Despite its title, section 328 does not really “limit” the amount of a professional’s compensation. To the contrary, it gives the professional the option of seeking pre-approval from the Court of the professional’s employment on any terms and conditions that the court may be persuaded to approve. In many instances, the employment terms will have no relation to the results achieved. For example, if the Court approves an hourly rate under section 328, then the professional will be paid that rate for time spent performing reasonable and necessary services, regardless of the size of the estate or results achieved during the representation.

Section 326 of the Bankruptcy Code (entitled “Limitation on compensation of trustee”) applies to trustee compensation only and takes a very different approach. Unlike section 328, it does not give trustees the option of having employment terms pre-approved by the Court. Therefore, the trustee has no entitlement to receive an hourly rate, contingency fee, flat fee or any other method of compensation. Instead, trustee compensation is always determined at the end of the case. More important, unlike section 328, section 326 imposes a *true* limit on trustee

compensation that is determined exclusively by the size of the estate. The trustee's compensation is capped at a dollar amount determined as a percentage of the amount of "moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims." 11 U.S.C. §326(a). Therefore, compared to the hourly professional, trustees face a much greater risk that reasonable and necessary services will not be compensated. See *In re Hance Meyer, Inc.*, 161 B.R. 839, 840 (Bankr. N.D. Cal. 1993) (bankruptcy court has no discretion to award trustee compensation in excess of maximum set forth in section 326(a)).

The Bankruptcy Code, therefore, virtually assures that a trustee will not be paid an hourly rate for the hours actually expended by her because if she does not distribute monies to creditors she gets nothing more than the nominal trustee fee. It does not allow a trustee to obtain pre-approval of a lodestar payment structure (even though other bankruptcy professionals like attorneys can). Thus, even if an hourly rate could be pre-approved for a trustee, her ability to be compensated would still be limited by and tied to the amount of distributions to creditors. Based on these differences, and in light of the clear language of the 2005 Act, it is clear now that Congress generally did not intend for trustee compensation to be a lodestar calculation, subject to a cap, as the Third and Tenth Circuits have held, but intended it to be a commission based on distributions to creditors. The function of Section 330 is to allow a court to reduce the percentage based commission where such compensation would be a windfall because the trustee did very little work in order to obtain the monies for distribution. Accordingly, after the enactment of the 2005 Act, this Court should place less weight on factors such as time spent and rates charged when determining reasonable trustee compensation. Since the trustee has no right to obtain from the estate a lodestar payment, the *value to the creditors in terms of a distribution* of a trustee's

services is far more relevant when determining reasonable compensation than the *lodestar* value of Trustee's services.

B. Trustee Compensation Must Be Reasonable.

The Trustee's requested compensation must be "reasonable" under section 330(a).⁵ The Court has wide discretion in this inquiry. The Bankruptcy Code does not explain how the facts are to be weighed in determining reasonableness.

The Court has wide discretion in considering the facts, weighing them and then awarding reasonable compensation to a trustee under the Bankruptcy Code. *See In re Borrego Springs Dev. Corp.*, 253 B.R. 271, 276-77 (S.D. Cal. 2000) (citations omitted). Simply put, "[i]t is an act of discretion rather than calculation." *In re Shaw*, 330 B.R. 113, 116 (Bankr. D. Vt. 2005); *accord In re Stoecker*, 118 B.R. 596, 605 (Bankr. N.D. Ill. 1990) ("[T]he applicable authorities provide no bright line test or formula to precisely decide the appropriate allowance in a wholly objective manner with any arithmetical certainty."). So long as the Court considers the appropriate facts in awarding compensation and does not exceed the statutory maximum, the Court's decision will be reversed only for an abuse of discretion. *See Borrego Springs*, 253 B.R. at 280 (reversing award of compensation determined exclusively by lodestar calculation because bankruptcy judge failed to consider other statutory factors under Section 330); *In re Benassi*, 72 B.R. at 46 ("A fee award will be reversed only if the bankruptcy court fails to apply the proper legal standard and procedure, or the award was based on clearly erroneous findings of fact.").

The reasonableness standard in section 330 applies to the compensation of Chapter 7 and 11 trustees, examiners, and professionals who are employed under section 327 or 1103 of the Bankruptcy Code. The problem, however, is that the various parties governed by this standard

⁵ The amendments to the Bankruptcy Code that added § 330(a)(3) (A)-(E) do not technically apply to this case as their effective date is to cases filed after the Merry-Go-Round Enterprises, Inc. case.

often have dramatically different roles and duties in bankruptcy cases. See *In re Guyana Development Corp.*, 201 B.R. 462, 476 (Bankr. S.D. Tex. 1996) (“The function of a trustee is different from that of all other professionals working for the estate.”); *In re Stoecker*, 118 B.R. at 601 (“The functions performed by trustees are substantially different from those of the attorneys who represent them.”) (citations omitted). As such, the factors for determining reasonableness should vary in importance based on issues such as the duties of the applicant and type of bankruptcy case at issue. Compare e.g., *In re Reconversion Technologies, Inc.*, 216 B.R. 46, 53 (Bankr. N.D. Okla. 1997) (most important factors in determining reasonableness of compensation to chapter 11 special counsel are rates charged and time spent) with *In re Copeland*, 154 B.R. 693, 699 (Bankr. W.D. Mich. 1993) (most important factor in determining reasonableness of compensation to chapter 13 attorney is the amount involved and results obtained).

Therefore, when determining whether a Chapter 7 trustee’s compensation is reasonable under section 330(a), the Court should look primarily to the results achieved in the case and the value to the estate of the trustee’s services. On the other hand, the Court should place less emphasis on factors that have little relevancy to maximizing the estate’s value and that do not even relate to comparable services.

Awarding percentage-based compensation under section 326(a) ensures that the trustee has an incentive to increase the size of the estate. At the same time, the reasonableness requirement in section 330(a) ensures that the trustee is not compensated based purely on the size of the estate (such as when the trustee does nothing more than come into possession of a large, unencumbered bank account). As one court explains:

By incorporating both percentage-based compensation and a reasonableness analysis, Congress creates an incentive to trustees

to search for all assets to maximize distribution to creditors as well as promotes a rational relationship between the effort expended and results obtained.

In re Guyana Development Corp., 201 B.R. at 480.

For these reasons, the benefits resulting from the trustee's efforts are the most important considerations when determining reasonable trustee compensation under section 330(a). *In re Draina*, 191 B.R. 646, 648 (Bankr. D. Md. 1995) ("The benefit to the estate is one of the primary factors to be considered in the allowance of compensation to a trustee."); *In re Cardinal Industries, Inc.*, 151 B.R. 843, 847 (Bankr. S.D. Ohio 1993) ("The focus must be on the result achieved and the benefit obtained for the estate."); *In re Stoecker*, 118 B.R. at 605 ("Maximum results justify maximum compensation.").

C. The Trustee's Requested Compensation Is Reasonable.

The Trustee seeks reasonable compensation under section 330(a) in an amount equal to the full commission allowable under section 326(a). The issue before the Court is whether the amount requested in this case is reasonable. Based on the extraordinary results accomplished by the Trustee and consideration of the nature, extent and value of the Trustee's services, the requested compensation is reasonable and within the Court's discretion. The requested compensation also is consistent with the amount of compensation awarded to trustees in other cases.

1. The Trustee's Requested Compensation is Reasonable in Light of the Results Obtained in this Case and Other Relevant Factors.

One fact cannot be disputed – the success of this case and ultimate size of the estate are a direct result of the Trustee's hard work, courage, creativity, judgment and pure resolve. The Trustee did not just stumble into an unencumbered \$294 million bankruptcy estate. Rather, she *created* this estate and every administrative, priority and unsecured creditor involved in this case

received a distribution far greater than what was predicted when the Trustee took over. In this regard, it is noteworthy that no creditor or equity interest holder objected to the requested compensation. *See In re Covad Communications Group, Inc.*, 292 B.R. 31, 32 (D. Del. 2003) (finding relevant fact that only opposition came from the Office of the United States Trustee and no creditors or equity security holders opposed fee enhancement to debtor's counsel).

Among other things, the Trustee:

- Turned an administratively insolvent estate into a \$294 million estate with 100% payouts to administrative and priority claimants and an expected 40% payout to unsecured creditors;
- Turned a failed restructuring into a successful Chapter 7 case by stabilizing the debtor's business operations and putting the stalled GOB Sale back on track, all within days of appointment and while facing an expected contested trustee election, and ultimately generated a recovery from non-litigation assets in excess of \$90 million;
- Pursued an unpopular, untried claim against fellow insolvency professionals and recovered a \$185 million settlement and industry-shattering result, all at no risk and no out-of-pocket cost to the estate;
- Reduced filed Chapter 11 administrative claims by \$112 million, secured claims by over \$10 million, priority claims by over \$40 million and general unsecured claims by over \$400 million; and
- Encountered, yet overcame, numerous obstacles in collecting and liquidating the estate's numerous assets, which were spread across the

country, and handled extremely sensitive and stressful issues with the Debtors' employees in winding down operations.

This list is just an example of the Trustee's numerous accomplishments in this case – additional results and obstacles faced by the Trustee are set forth in the Application and Devan Declaration. Taken together, and based upon the nature, extent and value of the Trustee's services, including the Trustee's extraordinary accomplishments, numerous hours of hard work and dedication, high distributions, industry changing litigation, plus the personal risk to the Trustee, an award of the requested compensation is "reasonable" under section 330(a) and within the Court's discretion.

2. The Trustee's Requested Compensation is Consistent With Compensation Awarded in Other Cases.

When determining the proper amount of trustee compensation, each case turns heavily on its facts. Therefore, it is virtually impossible to find an exact comparison case. What is reasonable in one case may not be reasonable in another.

It is not a stretch, however, to say that no Chapter 7 trustee has delivered the type of superb results that were accomplished in this case. There are cases, however, where the bankruptcy court found that a greater total amount of compensation was reasonable for a trustee. *See e.g., In re Southeast Banking Corporation*, 314 B.R. 250, 274 (Bankr. S.D. Fla. 2004) (concluding that compensation to Chapter 7 trustee in the amount of \$9,249,955 was reasonable under the Bankruptcy Code even though trustee engaged in willful misconduct during case); *In re Bennett Funding Group, Inc.*, Bankr. Case No. 96-61376 (Bankr. N.D.N.Y. Feb. 20, 2003) (awarding \$13.85 million as reasonable compensation to chapter 11 trustee).

In addition, other courts have awarded compensation to Chapter 7 trustees that results in a higher effective hourly rate than is sought by the Trustee here. *See In re Guyana Dev. Corp.*, 201 B.R. at 484 (approving compensation of \$2,398,348 for approximately 1,400 hours of work,

for an effective rate of roughly \$1,700 per hour); *In re Miniscribe Corporation*, 309 F.3d 1234 (10th Cir. 2002) (awarding \$1,828,812 in trustee compensation for 1,779 hours of work, for an effective rate of \$1,028 per hour). By comparison, the Trustee seeks compensation of \$8,835,000 for 9,891.7 hours of work, for an effective rate of \$893.17 per hour.

Finally, there also are cases where the trustee received a full commission even though the results achieved in those cases were less impressive. *See, e.g., In re Blue Coal Corporation*, 206 B.R. 730 (Bankr. M.D. Pa. 1997) (awarding maximum compensation to trustee that generated money in an insignificant amount relative to the size of the bankrupt, was not a “hands on” administrator and appeared to have delegated a great deal of his duties to others). Accordingly, whether looking at the facts of this case in isolation or in comparison to other cases, the compensation requested by the Trustee is reasonable under section 330(a) and within the Court’s discretion.

II. ALTHOUGH THE JOHNSON FACTORS SHOULD NOT APPLY TO CHAPTER 7 TRUSTEE COMPENSATION, THE TRUSTEE’S REQUESTED COMPENSATION IS REASONABLE UNDER THOSE FACTORS AS WELL.

The *Johnson* factors should not apply to Chapter 7 trustee compensation for all of the reasons discussed in Part I. above. Nevertheless, an analysis of them is included herein.

Appendix D: Compensation Guidelines for Professionals in the United States Bankruptcy Court for the District of Maryland, states, that

These guidelines shall apply to all professionals seeking compensation pursuant to 11 U.S.C. § 327, 328, 330 and 331, including attorneys, accountants, examiners, investment brokers and real estate advisors ...

Conspicuously absent from the inclusive list of “professionals” is the word, “trustee”. This is intentional because the factors do not apply. Nevertheless, as requested by the UST

Office, the Devan Declaration contains a lodestar analysis and discussion of the *Johnson* factors as required by Subpart D of Appendix D.

In awarding attorney compensation, courts in Maryland have looked to the 12-factor test set forth in *Barber v. Kimbrell's, Inc*, 577 F.2d 216 (4th Cir. 1978), as applied to the determination of attorney compensation in bankruptcy cases by *Harman v. Levin*, 772 F.2d 1150 (4th Cir. 1985). The factors in *Barber* are adopted from the Fifth Circuit's decision in *Johnson v. Georgia Highway Express, Inc* , 488 F.2d 714 (5th Cir. 1974).⁶ Nothing in the Bankruptcy Code, however, requires use of the *Johnson* factors with respect to chapter 7 trustee compensation.

Relying on a lodestar calculation when awarding trustee compensation, as contrasted with attorney compensation, has not been adopted by the decisions of the bankruptcy court in Maryland and should not be adopted because it may create two “caps” on trustee compensation - the lodestar “cap” (based on rates and hours) and the percentage-based cap in section 326 (which applies only to trustees). By calculating trustee compensation by the lodestar calculation, the trustee has an incentive to spend a lot of hours on the performance of duties and is not incentivized to concentrate time and effort on pursuing additional assets. It also may create conflicts of interest, such as when settling litigation,⁷ a result that Congress clearly sought to avoid when adopting the Bankruptcy Code. *See* Section I, above.

A straight lodestar test will, in many instances, be inadequate to compensate a trustee. *See In re Guyana Dev. Corp.*, 201 B.R. at 474 (finding that straight lodestar approach did not satisfactorily compensate chapter 11 trustee). In fact, relying *exclusively* on a lodestar

⁶ The *Johnson* factors, as applied to the calculation of an appropriate attorneys' fee, have subsequently been refined in a series of cases which held that many of the *Johnson* factors were subsumed in the initial calculation of hours reasonably expended at a reasonable hourly rate. *See, In re Great Sweats of VA, Inc*, 109 B.R. 696 (E.D. VA 1989). As modified, the *Johnson* factors have been dubbed the “lodestar”.

⁷ For example, in this case, if the Trustee knew in advance that payment above a lodestar would be difficult or impossible, then she would have had an incentive to accept the initial \$100 million offer from E&Y and not push harder for the addition \$85 million she obtained. This incentive would have placed her personal interests at odds with those of the estate's creditors – clearly an undesirable result.

calculation, without properly weighing the statutory and other relevant factors for determining reasonable compensation, may constitute reversible error. *See Borrego Springs*, 253 B.R. at 280 (reversing award of compensation determined exclusively by lodestar calculation because bankruptcy judge failed to consider other statutory factors under section 330).

If, however, the Court is inclined to apply the *Johnson* factors or a simpler lodestar test, this Court should follow the Tenth Circuit methodology announced in *Miniscribe*. In *Miniscribe*, the Tenth Circuit held that: (1) the lodestar test, with appropriate enhancements, is the appropriate method of calculating reasonable compensation for Chapter 7 trustee; (2) use of a unified hourly rate for all of trustee's services was appropriate approach in determining trustee's fee award; and (3) trustee was entitled to have 2.57 lodestar multiplier applied in calculation of his award.

There, the Trustee's request for compensation was analyzed first by calculating a "lodestar" -- that is, multiplying a reasonable hourly rate by the number of hours reasonably worked. Using that methodology here, through August 31, 2005, the Trustee spent 9,891.7 hours performing reasonable and necessary services for the estate. The Trustee did not separately bill for any legal services she performed for the estate. All legal services were billed solely as trustee time *See* Devan Declaration at ¶4. Applying the Trustee's normal hourly rate for attorney services at the time the work was done, the blended rate for her trustee services is \$256.32 per hour. *See* Devan Declaration at ¶5.

The Trustee's current hourly rate for performing attorney services is \$330 per hour.⁸ *See* Application at p.6 (Table B). The Trustee's hourly rate for attorney services, however, does not

⁸ It is appropriate for lodestar purposes to use the applicant's current rate so as to offset the effects of inflation and to compensate the applicant for the delay in payment. *See In re Miniscribe Corporation*, 257 B.R. 56, 61 (D. Colo. 2000), *rev'd on other grounds*, 309 F.3d 1234 (10th Cir. 2002); *In re D.C. Sullivan & Co.*, 69 B.R. 212, 218 (Bankr. D. Mass. 1986).

adequately compensate her for her services as trustee, which placed a much higher standard of performance on the Trustee than pure legal services. As the Tenth Circuit similarly explained:

[The role of trustee for the estate] is more difficult and more stressful than the role of legal counsel because it carries with it the burden of deciding how much is enough. The buck stops at the trustee's desk, not at the desk of legal counsel. He is entitled to some recognition for the nature of the position and the services provided in the role of trustee.

In re Miniscribe, 257 B.R. at 65. Therefore, a reasonable hourly rate for the trustee services performed in this case should be higher than the trustee's normal hourly rate for attorney services. *Id.*

Under the facts of this case and for purposes of the lodestar test, the Trustee should be compensated for her services at a rate of at least \$400 per hour. This rate is reasonable compared to the rates of other similar qualified professionals in this case. See Devan Declaration at ¶¶ 24-35, Exhibits 2 and 4. *Cf. In re Copeland*, 154. B.R. at 699 (“The bankruptcy court can rely on its own experience and knowledge as to what constitutes reasonable attorney’s fees.”) (citing *In re WHET, Inc.*, 61 B.R. 709 (Bankr. D. Mass. 1986)). This rate is also consistent with the hourly rate adjustment awarded to the trustee by the Tenth Circuit in *Miniscribe*. See 257 B.R. at 65 (finding \$400 per hour a reasonable rate for services performed by trustee whose hourly rate for attorney services was \$330 per hour). Assuming a reasonable rate of \$400 per hour, the Trustee’s basic “lodestar” for services performed through August 31, 2005 would be \$3,956,680 (*i.e.*, 9,891.7 hours x \$400 per hour).

Following *Miniscribe*, the court is to consider whether the Trustee is entitled to an enhancement multiplier of the lodestar fee. The Court should consider the results obtained and other *Johnson* factors when determining the appropriate lodestar multiplier. See *In re Miniscribe*, 309 F.3d at 1245. The Application and the Devan Declaration fully set forth the facts in the case

and the Devan Declaration discusses the facts in light of the *Johnson* factors. In summary, the most significant *Johnson* factors supporting an enhancement in this case are:⁹

- (i) Time and Labor Required. The Trustee performed 9,891.7 hours of largely complicated and highly stressful work, including on many nights and weekends. The Trustee also performed legal services for the estate that are not billed separately as legal time. A detailed description of the Trustee's services is set forth in the Application and Devan Declaration.
- (ii) The Novelty and Difficulty of the Questions. In this case, the Trustee faced many difficult, novel and challenging issues. Most significantly, the Trustee pursued the difficult and professionally risky litigation against E&Y. The Trustee also pursued the claim objection against Swidler, Berlin employee issues and concerns, and successfully completed the failed GOB Sale, resolved difficult tax claims and issues, marketed and sold the Debtors' main distribution facility, made interim distributions to creditors, and managed the prosecution of hundreds of avoidance actions and claim objections, the latter of which reduced the dollar amount of claims filed by approximately 65 percent.
- (iii) The Skill Requisite to Perform the Services Properly. The necessary services in this case were demanding and required skill, experience, imagination, ingenuity, dedication and courage. The Trustee performed numerous roles and functions, such as the chief executive officer and chief financial officer of a large and complex enterprise, investigator, attorney and, of course, fiduciary for the estate's numerous creditors.
- (iv) The Preclusion of Other Employment. The Trustee is the senior partner of her firm's bankruptcy practice. Her appointment as trustee in this case significantly impacted her ability to develop new relationships and business opportunities, handle cases generated by other attorneys in her firm, and continue representing her existing clients.
- (v) Time Limitations Imposed by the Circumstances of the Case. Immediately upon her appointment, the Trustee was forced to become actively involved in this case, requiring numerous hours of hard and stressful work. The Trustee worked 3,234.9 hours in the first 23 months on this case alone (an average of over 140 hours/month) and was hospitalized in the process. She made numerous other personal sacrifices. These initial efforts, however, were necessary to get the case on the right track and directly led to its ultimate success.
- (vi) The Results Obtained. The results in this case were nothing short of phenomenal. The Trustee pursued risky and novel claims against a national accounting firm, masterfully completed the failed GOB Sale, overcame numerous obstacles in collecting and liquidating the estate's

⁹ A more detailed discussion of the applicable *Johnson* factors is set forth in the Devan Declaration.

numerous other assets (which were scattered throughout the country) and ultimately increased the amount of cash in the estate from \$2 million to \$294 million. She also reduced the amount of secured claims against the estate by over \$10 million, reduced Chapter 11 administrative claims by \$112 million, reduced priority claims by nearly \$41 million and reduced general unsecured claims by \$401 million. Standing alone, the results in this case support a substantial enhancement multiplier to the Trustee's lodestar.

- (vii) Experience, Reputation and Ability of the Trustee. The Trustee has roughly 30 years of legal experience and has served as a trustee under the Bankruptcy Code and former Bankruptcy Act. She has served as a Chapter 7 trustee in approximately 8,500 to 9,000 bankruptcy cases and has also served as a Chapter 11 trustee. She also was a standing Chapter 13 trustee from 1979 to 1984 and was instrumental in developing the Chapter 13 procedures for the Bankruptcy Code. Among numerous other memberships and honors, the Trustee is a member of the prestigious American College of Bankruptcy and has been named one of the "Best Lawyers in America" in the field of bankruptcy for over 10 years. The Trustee's complete curriculum vitae is attached to the Devan Declaration as Exhibit 3.
- (viii) The Undesirability of the Case. Although others may have initially desired to serve as Chapter 7 trustee in this case, the likely prospect of not having sufficient assets to pay the trustee after secured creditors were paid and the fact that the appointment turned out to be extremely challenging and stressful in many respects made the case less desirable. Administering this case has required the Trustee to deal with difficult employee issues, make decisions that have jeopardized her professional career and source of referrals, and endure opposition (sometimes strong opposition) regarding her investigation and prosecution of the E&Y litigation. Moreover, since the E&Y claim was brought, the Trustee has not received a single referral of business from a national accounting firm. While the Trustee takes personal reward from her accomplishments, the services required in this case have been far more demanding and stressful than the services she typically performs as attorney or trustee in other cases.
- (ix) Awards in Similar Cases. As discussed in Section IV(B) above, the compensation requested by the Trustee is consistent with the trustee compensation awarded in other cases. There are cases where (i) the bankruptcy court found that a greater total amount of trustee compensation was reasonable, (ii) the bankruptcy court awarded trustee compensation in an amount that results in a higher effective rate than what the Trustee seeks here, and (iii) the trustee received a full commission even though the results achieved in those cases were less impressive.

Based on the exceptional results in this case and consideration of the applicable *Johnson* factors, and assuming a reasonable rate of \$400 per hour, an enhancement multiplier of 2.5 to 3.0 is appropriate in this case. *See* Hazard Declaration at ¶8. A multiplier in this range is consistent with that awarded to other Chapter 7 trustees. *See e.g., In re Miniscribe*, 309 F.3d at 1245 (awarding enhancement multiplier of 2.57 for lodestar calculation) (and cases cited therein). Accordingly, the Trustee's enhanced lodestar in this case is no less than \$9,891,700. As such, to the extent the lodestar test applies, the Trustee's requested compensation of \$8,835,000 (as limited by section 326(a) of the Bankruptcy Code) is reasonable.

III. CONCLUSION.

Based upon the forgoing, the Application should be granted and the Trustee should be awarded \$8,835,000 as reasonable compensation in accordance with section 330 of the Bankruptcy Code.

Respectfully submitted at Baltimore, this 1st day of December, 2005.

/s/ Deborah H. Devan
Deborah H. Devan, Esquire
Federal Bar No. 01479
NEUBERGER, QUINN, GIELEN,
RUBIN & GIBBER, P.A.
One South Street, 27th Floor
Baltimore, Maryland 21202-3282
dhd@nqgrg.com
(410) 332-8550
Chapter 7 Trustee for Merry-Go-Round
Enterprises, Inc.

Of Counsel:

Keith J. Shapiro, Esquire
Thomas E. Dutton, Esquire
David W. Baddley, Esquire
Greenberg Traurig, LLP
77 West Wacker Drive, Suite 2500
Chicago, Illinois 60601

228209:1137.89