Delaware Bankruptcy Court Reinforces that Hindsight is not a Basis to Object to Indenture Trustee Fees

By Christopher J. Giaimo, Jeffrey N. Rothleder / Mar 24, 2017

Introduction

In the Chapter 11 case of *Nortel Networks Inc., et al*. ("*Nortel*"), pending in the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court"), a group of senior noteholders (the "Noteholders") objected to the fees and expenses sought by Delaware Trust Company, as successor indenture trustee (the "Indenture Trustee"). Specifically, the Noteholders argued that the fees and expenses sought were unreasonable and should not be deducted from their recovery because, among other things, the bulk of the fees were for time spent by the Indenture Trustee in carrying out its duties as a member of the Official Committee of Unsecured Creditors (the "Committee") or that the Indenture Trustee should have relied on other professionals to do the work. The Bankruptcy Court overruled the Noteholders' objection and held that the fees and expenses were reasonable and the services giving rise to such were a prudent exercise of the Indenture Trustee's obligations under the relevant documents.

Background

The recent decision in *Nortel* stems from the long and complex bankruptcy of Nortel Networks and its multi-national affiliates. The cases, commenced in 2009, involved a complex reorganization involving numerous mediations, litigations and various other contested matters which ultimately led to a confirmed plan of reorganization. The Indenture Trustee, at the direction of the Bankruptcy Court and pursuant to its duties under the relevant indenture documents, participated in almost every stage of that process, beginning at the earliest stage when it was appointed to serve as a member of the Committee, which it did for the duration of the cases. Through it all, the Indenture Trustee and its various counsel incurred approximately $8.1 million in fees and expenses.

Pursuant to the confirmed plan of reorganization (the "Plan"), the Debtors paid the Indenture Trustee up to $4.5 million of the Indenture Trustee's outstanding fees and expenses. As set forth in the indenture documents, the Indenture Trustee was then permitted to exercise its right to payment of the remaining amount of fees and expenses from the distributions to be paid to the Noteholders under the Plan, *i.e.* the charging lien.

Before the Indenture Trustee was paid, the Noteholders objected to the amount of the fees and expense sought by the Indenture Trustee. The Noteholders argued that the Indenture Trustee should not be entitled to compensation for the fees and expenses incurred for work performed by the Indenture Trustee and its counsel in (i) carrying out its role as a member of the Committee, (ii) participating in the "Allocation" trial and (iii) doing certain other ministerial and administrative tasks.

Analysis

The Bankruptcy Court overruled the Noteholders' objection.[1] In doing so, the court began with an analysis of the role of an Indenture Trustee and its obligations under both the relevant indenture documents and the Trust Indenture Act. The court stated that once an event of default occurred under the indenture documents, the Indenture Trustee was then authorized to perform such duties as a prudent person would and that it could do so through its agents and attorneys. Thus, the Bankruptcy Court found that an Indenture Trustee who employs counsel that performs tasks in furtherance of the trustee's duties is permissible under the indenture documents and the Trust Indenture Act. Therefore, the work of the Indenture Trustee and its counsel, so long as it was prudent, would be compensable.

The next question the Bankruptcy Court considered is whether the Indenture Trustee and its counsel acted prudently. Under New York law, the applicable governing law, the court stated that the test for prudence is "whether the trustee exercised 'such diligence and such prudence . . . . as in general, prudent men of discretion and intelligence in such matters, employ in their own like affairs.'" *See In re Nortel Networks, Inc. et al.*, 2017 Bankr. LEXIS 674, at *7 (Bankr. D. Del. Mar. 8, 2017) (citing *In re Bank of N.Y.,* 323 N.E. 2d 700 (1974)). The court further stated that it cannot review prudence in hindsight but must **look at it at the time the Indenture Trustee acted**. In other words, a court should not second guess what was done by an Indenture Trustee during the case through the lens of the end result of the case but must, instead, look at the decisions made in the context of the circumstances of the time those decisions were actually made. Consequently, the Bankruptcy Court found that the question it would decide is whether "the Indenture Trustee acted prudently in assigning the Lawyers to their tasks, and whether the Lawyers' work was reasonable." *In re Nortel*, 2017 Bankr. LEXIS 674, at *8. The Bankruptcy Court answered that question in the affirmative.

In reaching this conclusion, the court noted that the Noteholders failed to raise any issue with the work or tasks being performed by the Indenture Trustee or its counsel until the end of the case. To this court, this is the very hindsight analysis that was not permissible. Rather, when looking at the circumstances of the cases, the Bankruptcy Court found that the Indenture Trustee and its counsel were, for the most part, prudent and reasonable. The court cited at least nine examples of such prudent decisions and behavior.

The Bankruptcy Court overruled the Noteholders' primary objection that the Indenture Trustee and its counsel should be able to recover fees and expenses for performing work in its capacity as a Committee member. Specifically, the judge in *Nortel* found that since the Indenture Trustee was entitled to act through its counsel, having its counsel attend Committee meetings and protect the interests of the Noteholders together with all unsecured creditors, was prudent at the time the services were performed. In reaching this conclusion, the court again relied on the fact that the Noteholders' objection was based on hindsight, and thus not an appropriate method for assessing the prudence of the actions taken by the Indenture Trustee and its

counsel. The judge stated that it "was implausible for the Indenture Trustee or the Lawyers to know whether at the time they were performing the work that the Noteholders' interests did not need protection, or whether what they learned through the Committee would be of no benefit to the Noteholders." *In re Nortel*, 2017 Bankr. LEXIS 674, at *17. The Bankruptcy Court found that the Indenture Trustee and its counsel could not have known that the work they performed during the cases, including work as a Committee member, would either be duplicative of others or result in a tangible benefit to the Noteholders. As the Bankruptcy Court aptly stated, "[t]he matters at hand were too important to leave to chance that the Committee Work would have no impact on or significance to the Notes." *Id*. Thus, the Bankruptcy Court overruled this portion of the objection.

Likewise, the Bankruptcy Court overruled the other objections asserted by the Noteholders. Indeed, the court found that since the Indenture Trustee represented an important constituency in the reorganization, its full and engaged participation was necessary and prudent. Thus, the suggestion that the Indenture Trustee could "parachute in" and "parachute out" of certain matters, including mediations and contested matters, was another construction of hindsight that ignored the realities of the cases and the prudent actions that the Indenture Trustee was required to take.

Finally, the court ruled that the Indenture Trustee and its counsel were entitled to recover fees incurred in defending the Noteholders' objection notwithstanding the "American Rule" and the Supreme Court's decision in *Baker Botts L.L.P. v. ASARCO*, 135 S. Ct. 2158, 2161 (2015). In *ASARCO*, the Supreme Court held that an estate professional was not entitled to recover fees incurred in defending its fee objection against objection. The court in Nortel found that the *ASARCO* ruling did not apply to the Indenture Trustee because the indenture documents, a contract, clearly modified the "American Rule" to permit the Indenture Trustee to recover fees and expenses for "defending itself . . . ." *Id*. at *23.

Accordingly, except for clean-up items and voluntary reductions by counsel, the Bankruptcy Court overruled the Noteholders' objections and found that the fees and expenses sought by the Indenture Trustee and its counsel were reasonable and incurred in the exercise of prudent decision making to protect the interests of the Noteholders.

Take Away

The decision in *Nortel* is important in that it reinforces that right of the Indenture Trustee to act through its own counsel and to take reasonable, prudent steps during a case to ensure that the interests of its holders are protected. The court's explicit rejection of a hindsight analysis is an important statement to ensure that future Indenture Trustees do not face the same attack from their holders. Indeed, this decision provides further guidance that Indenture Trustees should be active in the matters for which they serve and that they should, during the duration of the cases, monitor the tasks being performed by their counsel and review invoices on as current a basis as possible.

If you have any questions regarding the content of this alert, please contact Jeffrey N. Rothleder at jrothleder@clarkhill.com | (202) 640-6669, Christopher J. Giaimo at cgiaimo@clarkhill.com | (202) 640-6670, or another member of Clark Hill's Corporate Restructuring & Bankruptcy practice group.

[1] The Bankruptcy Court did reduce the fees and expenses owed to the Indenture Trustee in a relatively minor amount based on the court's independent review of the time records submitted.