UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
NEWNAN DIVISION

IN THE MATTER OF:	:	**CASE NUMBER**
	:	
DAN RIVER, INC., et al.	:	04-10990-WHD
	:	
	:	IN PROCEEDINGS UNDER
	:	CHAPTER 11 OF THE
DEBTORS.	:	BANKRUPTCY CODE

O R D E R

Before the Court is the Final Application for Compensation of Conway Del Genio, Gries & Co., LLC (hereinafter "CDG"), Financial Advisors for Dan River, Inc. and Related Debtors. The Official Committee of Unsecured Creditors (hereinafter the "Committee") and Dan River, Inc. (hereinafter the "Reorganized Debtor") have objected to the Application. Following a hearing held on May 10, 2005, the Court took the Application under advisement.

BACKGROUND AND FINDINGS OF FACT

In April 2003, Dan River, Inc. and its affiliates (hereinafter the "Debtors") entered a credit agreement (hereinafter the "Credit Agreement") with Deutsche Bank Trust Company Americas, as Agent, Fleet Capital Corporation, as Syndication Agent, Wachovia Bank, National Association, as Documentation Agent, and various lenders (collectively referred to herein as the "Lenders"). *See* Affidavit of Barry Shea, Docket Number 31 (hereinafter "Shea Affidavit"), at 4. The Credit Agreement provided for a five-year term

loan of $40 million and a revolving credit facility of $160 million. *See id*. Prior to that time, the Debtors had refinanced their long-term debt by selling $157 million of senior notes due in 2009. *See id*. Also in fiscal year 2003, the Debtors began to experience a decline in revenues from the sale of textile products. *See id*. at 4-5. As a result of the Debtors' performance throughout 2003 and 2004, the Debtors failed to comply with certain covenants within the Credit Agreement. *See id.* at 5.

In October 2003, the Debtor's retained CDG to assist the Debtors in dealing with the Lenders. *See* Testimony of Robert Del Genio, Transcript of May 10, 2005 Hearing (hereinafter "Hearing Transcript"), at 18. CDG helped the Debtors obtain several amendments to the Credit Agreement, through which the Lenders waived the Debtors' compliance with the covenants. *See id*. at 42. However, the amendments also imposed additional requirements on the Debtors, such as the obligation to deliver by March 31, 2004 satisfactory evidence to the Lenders that the Debtors would be in compliance with the Credit Agreement's financial covenants for the first fiscal quarter of 2004. *See* Shea Affidavit, at 6. As the March 31st deadline approached, the Debtors recognized that they would not in fact be in compliance with the covenants. Nonetheless, the Debtors still felt that they did not need to file for bankruptcy protection if they could get the Lenders' support. *See* Testimony of Barry Shea, Hearing Transcript, at 104. At a meeting with the Lenders on March 3, 2004, the Debtors and CDG learned that the Lenders would not waive the impending defaults, and the Lenders told the Debtors that they should prepare to file for bankruptcy. *See* Testimony of Robert Del Genio, Transcript of April 27th Hearing

(hereinafter "April 27th Hearing Transcript"), at 65; Shea Testimony, Hearing Transcript, at 104.

Following that meeting, CDG began working to find debtor-in-possession financing for the Debtors. *See* Del Genio Testimony, Hearing Transcript, at 42; Del Genio Testimony, April 27th Hearing Transcript, at 41. CDG began negotiations with the Lenders, but also talked with a number of other lenders, including Merrill Lynch, GE, Wells Fargo Foothill, Citigroup, Bank One, CIT, JP Morgan, Cerberus, CSFB, and Fleet. *See* Del Genio Testimony, April 27th Hearing Transcript, at 41-42. The Debtors continued negotiations and due diligence with Citigroup and the Lenders. *See id*. On the evening prior to the filing of the Debtors' petitions, Citigroup dropped out of the negotiations, and the Debtors entered a financing agreement with the Lenders. *See id*. at 43-44. For its pre-petition services to the Debtors, CDG received fees in the amount of $746,321, which included a retainer of $150,000. *See* Declaration of Robert Del Genio, Exhibit B to Debtor's Application to Employ CDG, Docket Number 12, at 2.

On March 31, 2004, Dan River, Inc. and its affiliates (hereinafter the "Debtors") filed a voluntary petition under Chapter 11 of the Bankruptcy Code. The United States Trustee appointed the Committee on April 12, 2004. As part of the Debtors' "first day motions," the Debtors filed an application to employ CDG (hereinafter the "Employment Application") as their financial advisor. In the Employment Application, the Debtors requested authority to continue their employment of CDG pursuant to section 327 and section 328, which the application stated permits the Debtors to "engage CDG on any

reasonable terms and conditions." Employment Application, Docket Number 12, at 6 & 10. The Employment Application further stated that CDG would file a fee application with the Court in accordance with the applicable provisions of the Code and the Federal and Local Bankruptcy Rules. *Id*.

The Employment Application summarized the proposed compensation to be paid to CDG, which included a $150,000 per month flat fee, a restructuring fee, and reimbursement of expenses. *See id.* at 6. The Employment Application also incorporated the terms of an attached engagement letter between the Debtors and CDG, dated March 26, 2004. *See id.* at 7. The restructuring fee, as originally proposed, consisted of 1% of the Company's debt securities and financial and trade indebtedness (as of October 17, 2003) that would be subject to restructuring, less an offset of $75,000 per month of the engagement. *Id*. at 10. Additionally, the restructuring fee was to be paid if the Debtors emerged from Chapter 11 as reorganized entities or if the companies were sold during the course of the Chapter 11 proceedings, but not if the Debtors' cases were converted to cases under Chapter 7. *See* Del Genio Testimony, Hearing Transcript at 21. If the original $75,000 per month offset (50% of each monthly fee earned) had remained in place, the amount of the restructuring fee would have been reduced to zero if the Debtors had not emerged from bankruptcy within three years. *See id.* at 22.

On April 1, 2004, the Court entered an order approving CDG's employment, subject to the objection of any party within 40 days. *See* Docket Number 45. The Interim Order states that "[s]ubject to objections, the Debtors are authorized to continue their engagement

of [CDG] . . . on the terms set forth in the Motion and the engagement letter attached thereto." *Id*. Further, the Interim Order provides that "CDG shall be compensated upon appropriate application in accordance with Section 330 and 331 of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, and the Local Bankruptcy Rules and orders of this Court." *Id*.

On May 11, 2004, the Committee objected to the Employment Application. *See* Docket Number 222. The Committee asserted that the proposed compensation was excessive, should not be approved in advance at a time when the parties could not judge the quality of the services rendered, and did not provide a proper economic motivation for CDG to maximize the value of the Debtors' estates because it was payable regardless of the success of the case or the recovery to the creditors. The Committee also objected to the fact that CDG had previously earned $600,000 in fees for pre-petition services, none of which would be deducted from the restructuring fee, and that only 50% of the post-petition monthly fees earned would be deducted from the restructuring fee. *Id*. at 2. For these reasons, the Committee urged the Court to either deny approval of CDG's employment or condition it upon a reduction of the restructuring fee by 100% of any monthly fees earned by CDG. *Id*. at 3. The Committee's objection to the application was set for hearing on June 29, 2004. Prior to the hearing date, the parties engaged in "very active" negotiations regarding the terms of CDG's employment. *See* Del Genio Testimony, Hearing Transcript, at 23-24. A consensus having been reached, the Committee withdrew its objection, and the Debtors' counsel submitted a proposed order for the Court's approval and signature. *See*

id. at 24.

The final order approving the employment of CDG, entered on June 29, 2004, authorized the Debtors to continue the engagement of CDG "on the terms set forth in the Interim Order, the Motion, and the engagement letter" with certain exceptions. *See* Final Order Approving Employment of CDG, Docket Number 410. The Final Order changed the terms of the compensation by requiring CDG to credit 75%, rather than 50%, of its monthly fees earned from October 31, 2004 through March 31, 2005 and 100% of its monthly fees earned thereafter against the restructuring fee. Further, the Final Order provided for the restructuring fee to be reduced by $37,500. *See id*. The new compensation arrangement resulted in approximately $169,000 less than CDG could have earned under the Interim Order. *See* Testimony of Del Genio, Hearing Transcript at 23. Had the Debtors remained in bankruptcy for two years, the restructuring fee would have been reduced to zero. *See id.* at 24.

During the same time frame, the Committee sought to employ Houlihan Lokey Howard & Zukin (hereinafter "Houlihan Lokey") as its own financial advisor. *See* Application to Employ Houlihan Lokey, Docket Number 244. The United States Trustee and the Committee negotiated the terms of that engagement. A proposed final order approving the employment was submitted by counsel and entered on July 13, 2005. *See* Amended Order Authorizing Employment and Retention of Houlihan Lokey, Docket Number 488. The Houlihan Lokey Retention Order stated that "the compensation . . . to be paid to Houlihan Lokey shall be in accordance with the terms of the Application and the

Engagement Letter, which fees and expenses shall not hereafter be subject to challenge except under the standard of review under Section 328(a), provided, however, solely as to the Office of the United States Trustee, such fees . . . shall hereafter be subject to challenge under the standard of review under Section 330." *Id*. at 2. The Houlihan Lokey Retention Order also specifically stated that the "Transaction Fee" payable to Houlihan Lokey would not be pre-approved and that the parties' rights to negotiate the fee and to object to the fee would be preserved. *See id*. at 2-3. The Order required Houlihan Lokey to file interim and final fee applications in accordance with sections 330 and 331, but excused the firm from keeping detailed time records. *See id* at 4.

On March 31, 2005, CDG filed its final fee application, which requests payment of the full restructuring fee, less the offset for its monthly fees, in an amount of $1,807,360. *See* CDG's Final Application for Compensation, Docket Number 1158; Amended Final Application for Compensation, Docket Number 1195. The Committee filed an objection to the application, in which the Reorganized Debtors joined. *See* Committee's Objection to CDG's Final Application for Compensation, Docket Number 1192; Dan River, Inc.'s Limited Objection to CDG's Final Application for Compensation and Joinder, Docket Number 1194. In its amended application, CDG reserved its right to seek indemnification for its fees and expenses incurred in defending the Application. *See* Amended Final Application, Docket Number 1195. In its amended fee application and post-hearing brief, CDG requests permission to file a supplemental application for those fees.

CONCLUSIONS OF LAW

The Bankruptcy Code provides two standards for the approval of compensation to be paid to professionals employed pursuant to section 327. The first is found within section 330, which provides that the bankruptcy court, after notice and a hearing, may award to a professional employed pursuant to section 327 or 1103 reasonable compensation for actual and necessary services rendered and reimbursement of expenses. *See* 11 U.S.C. §§ 330(a)(1). Section 330 allows the court the express leeway to review compensation after the services have been rendered and award compensation less than that requested, but mandates that the court consider the nature, extent, and value of the services rendered in determining the amount of compensation. *See id.* §§ 330(a)(2)-(3). The alternative method is found in section 328, which permits a trustee or debtor-in-possession, with the court's approval, to "employ . . . a professional person under section 327 . . . on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on contingent fee basis." *Id.* §§ 328(a). If compensation terms are approved in advance of the services being rendered, the court may alter the pre-approved compensation arrangement only 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." *Id.* Accordingly, under section 328, the court has no opportunity, absent developments not capable of anticipation, to consider in hindsight the actual services rendered or the results obtained.

In this case, the question is whether the Court pre-approved the specific compensation arrangement between the Debtors and CDG. If so, section 328 will control, and the Court will not be permitted to alter the terms of CDG's pre-approved compensation unless the Court finds that the terms were improvident in light of developments that were not capable of being anticipated at the time the Court approved CDG's employment. If the Court did not approve the compensation in advance, the Court must assess the reasonableness of the requested compensation in accordance with section 330 and adjust the compensation if appropriate.

The appellate courts that have addressed this issue have demanded varying levels of formality "before a term of compensation is deemed 'approved' pursuant to" section 328. *In re Airspect Air, Inc.*, 385 F.3d 915, 921 (6th Cir. 2004) (discussing the holdings of the Third, Fifth, and Ninth Circuit Courts of Appeals). For example, in the Third Circuit, the order approving the compensation must "expressly and unambiguously state specific terms and conditions (*e.g.*, specific hourly rates or contingency fee arrangements) that are being approved." *Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc.*, 50 F.3d 253, 261-62 (3d Cir. 1995).

The Ninth Circuit Court of Appeals requires that the professional be "unambiguously employed pursuant to § 328," which is accomplished by invoking section 328 "explicitly in the retention application." *In re Circle K Corp,* 279 F.3d 669, 674 (9th Cir. 2002). Notably, although the Ninth Circuit Court of Appeals specifically urged bankruptcy courts to specify in the order whether section 330 or 328 controlled, the court did not require this,

noting that "failure to cite either § 330 or § 328 is not fatal, as the context of the retention order should ordinarily make clear which provision is applicable." *Id.* at 674 n.5.

In the Fifth Circuit, the applicant need not specifically mention section 328 in the application, and the court need not specifically refer to section 328 in the order approving the compensation. *See Matter of National Gypsum Co.*, 123 F.3d 861, 862 (5th Cir. 1997). In *National Gypsum*, despite the fact that the order reserved the court's "right to consider and approve the reasonableness and amount of [the professional's] fees on both an interim and final basis," the Fifth Circuit Court of Appeals held that the bankruptcy court had pre-approved the fee arrangement and, therefore, section 328 controlled the issue of whether the fees should be allowed. *Id.* at 863. As to the language of the employment order, the court noted that such language only indicated that the bankruptcy court would retain control over the fees "in the event of subsequent and unanticipated circumstances affecting the reasonableness of the agreed fee." *Id.*

After considering the holdings of its sister circuits, the Sixth Circuit Court of Appeals rejected the holdings of the Third and Ninth Circuit Courts of Appeals as being "too constrictive." *Airspect Air*, 385 F.3d at 921. The court noted that the statute itself does not require specific reference to section 328 in the application or the order. *Id.* Recognizing that the default rule should be that fees are subject to review under section 330, the court concluded that something more than the mere reference to a compensation agreement within the employment application must be required to alter that default rule. *See id.* The court struck a compromise between the two extremes by adopting a "totality of the circumstances"

test for determining whether section 328 applies to a particular professional's compensation. *See id.* at 922. This test requires the court to consider both the application for employment and the order authorizing the employment. *See id.* After considering these factors, the court concluded the bankruptcy court had not pre-approved the compensation at issue. The only fact in the case that suggested the court had pre-approved the compensation was the fact that the employment application described the compensation arrangement between the trustee and the attorney. *See id.* The court concluded that the "rest of the circumstances overwhelm[ed] the application's lone reference to § 328." *Id.* Specifically, neither the application nor the order referenced section 328 or discussed the reasonableness of the fee. Further, the order failed to mention the contingency fee and required the attorney to submit fee applications for the bankruptcy court's approval. *See id.*

Having considered the various opinions of the Courts of Appeals on this issue, the Court agrees with the Sixth Circuit Court of Appeals that all of the circumstances of the case should be considered in determining whether a bankruptcy court has reviewed and pre-approved specific employment terms. Section 328 does not require that an order or an application refer specifically to section 328. Such a reference is certainly evidence that the court and other parties were on notice that the applicant expected to have its fees pre-approved and that the court did in fact review the reasonableness of the proposed employment terms. However, if the circumstances surrounding the approval of the employment suggest that the court considered the reasonableness of the employment terms at the outset of the case, the lack of such a reference should not be a *per se* bar to a finding

of pre-approval. By considering all of the circumstances of the case, a court can better determine whether the bankruptcy court reviewed fully the reasonableness of the terms at the time the employment was authorized.

That being said, when the bankruptcy court is asked to review its own order to determine whether employment terms were pre-approved, the court is in the best position to know whether such a review was in fact undertaken. In this case, the Court was aware that the Debtors and CDG intended to have the employment terms pre-approved, the Court had access to the necessary information to determine that CDG's employment terms were reasonable, and the Court considered that information when it entered the final CDG retention order. Accordingly, the Court must conclude that it did in fact review CDG's proposed employment terms, including the compensation, and made an independent determination that the employment terms were reasonable under the circumstances of the case.

In the Employment Application, the Debtors clearly requested approval of CDG's compensation in advance in accordance with section 328. The Court and all parties in interest were on notice that the Debtors were seeking pre-approval of CDG's compensation. Because of this fact, the Court and the parties subjected CDG's application and compensation terms to additional scrutiny.

The Employment Application also described the nature of the services that would be rendered by CDG and explained why the Debtors believed that continuing the pre-petition engagement of CDG would be "essential" to the Debtors' reorganization. The Employment

Application disclosed in detail the terms of the proposed compensation by summarizing the fee arrangement and by incorporating by reference the actual fee agreement, which was also attached to the application. Consequently, the Court and all parties were aware that CDG would be paid a flat monthly fee and a restructuring fee. The parties were also aware that, although the fee was contingent, the payment of the fee would not depend upon the amount paid to unsecured creditors. Additionally, by the time the Court entered the final CDG retention order, the Court and the parties were made aware by the Committee's written objection that the parties anticipated the amount of the restructuring fee to reach at least $1.8 million.

Following the entry of the interim CDG retention order, the Committee objected to the proposed compensation. The Committee complained that the total compensation received by CDG would be excessive if the Court did not require CDG to reduce its monthly flat fee by more than 50%. The Committee also objected to the structure of the fee and argued that the fee would not motivate CDG to strive for the best result in the case, as the restructuring fee was payable regardless of the return to creditors. The Committee asked the Court to either deny approval of CDG's employment or condition it upon a reduction of the restructuring fee by 100% of any monthly fees earned by CDG. Prior to the scheduled hearing, the Court considered the Committee's objection in preparation for the hearing. However, the Committee, CDG, and the Debtors negotiated the issue at some length and reached a compromise, which was presented to the Court when the parties asked the Court to remove the matter from its Court calendar. The Court considered the new terms

of CDG's employment, as well as the information available to the Court regarding CDG's qualifications, the nature of the work to be performed, and its own experience with regard to such applications, in deciding whether to enter the proposed order prepared and submitted by the Debtors' counsel. See *In re Chewning & Frey Securities, Inc.*, 328 B.R. 899, 913 n.5 (Bankr. N.D. Ga. 2005) (Mullins, J.) (noting that a bankruptcy court is permitted to rely upon its own experience in assessing the reasonableness of proposed compensation).

The Court recognizes that the CDG retention order is not as clear as the Houlihan Lokey retention order as to whether the standard of review would be that found in section 328 or that found in section 330. However, it should be noted that the two orders were not prepared by the Court, or even by the same attorneys. Additionally, the Court reviewed and entered the final CDG retention order prior to reviewing and entering the Houlihan Lokey order. Therefore, the orders should not be compared in order to divine the intent of the Court. The inclusion of specific language in the Houlihan Lokey order and not in the CDG order does not indicate that the Court reviewed Houlihan Lokey's compensation terms in advance, but not CDG's.

In fact, when the Court reviewed the proposed final order authorizing CDG's employment, the Court noted that the order authorized the Debtors to continue the engagement of CDG "on the terms set forth in the Interim Order, the Motion, and the engagement letter." The final order incorporated both the Motion, in which the Debtors had requested authority to employ CDG pursuant to 328, and the engagement letter, which contained the specific employment and compensation terms that the Debtors and CDG

sought to have pre-approved. At that time, it was the Court's understanding, given the language of the proposed final order and the fact that the parties had negotiated a reduction in the overall compensation, apparently without preserving the right to challenge the restructuring fee at the conclusion of the case, that the parties were seeking advanced approval of the compensation. For that reason, the Court reviewed the new compensation prior to entering the final order.

It is true, as the Committee points out, that the final CDG retention order incorporates the interim order, which provides that "CDG shall be compensated upon appropriate application in accordance with Section 330 and 331 of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, and the Local Bankruptcy Rules and orders of this Court." *Id*. At the time the Court entered the final order, the Court did not interpret this reference to sections 330 and 331 as an indication that the standard of section 330 would apply to CDG's compensation. Instead, the Court assumed that this reference simply confirmed that CDG would be required to file "an appropriate application" prior to being compensated.

When a bankruptcy court has blessed a particular compensation arrangement in advance, such approval does not authorize a debtor free reign to pay the fee without permission of the bankruptcy court. Even fees pre-approved under section 328 must be applied for, in accordance with the procedures set forth in section 330, and authorized by the bankruptcy court because the court retains jurisdiction over the fee in the event that circumstances arise that were not capable of anticipation at the time the court considered the matter. If a professional were not required to file a fee application and the court were not

required to provide notice and an opportunity for a hearing, as required by section 330, there would be no further opportunity for parties in interest to object on the basis that the pre-approval of the fee was improvident. *See In re Westbrooks*, 202 B.R. 520, 522 (Bankr. N.D. Ala. 1996) ("If the Court has pre-approved the fee arrangement, pursuant to § 328, as it did here, and the attorney seeks to be compensated from estate funds, he still must make a fee application as provided in § 330(a) of the Code and through the procedure established by Bankruptcy Rule 2016.").

Further, all of the professionals in this case were permitted to seek and be paid interim compensation. *See* Order Establishing Procedures for Monthly Compensation and Reimbursement of Expenses of Professionals, Docket Number 183. Pursuant to the Order, the professionals were required to serve a monthly statement upon counsel for the Debtors, the Committee, and the Lenders. At that point, the Debtors were permitted to pay 80% of the fees requested and all expenses. The professionals were also required to file an interim fee application, pursuant to sections 330 and 331 and Rule 2016, every 120-180 days. The Order contemplated that the Court would hear these applications after all parties had at least 45 days to object. This requirement is consistent with the mandate of section 331, which provides that the court "may allow and disburse" interim compensation only after notice and a hearing. 11 U.S.C. § 331. Section 331 also requires professionals to "apply" for such interim compensation. *Id*. Accordingly, in order for a professional employed pursuant to section 327 to be paid interim compensation, regardless of whether the compensation has been reviewed under section 328 or remains to be reviewed under the standard found in

section 330, the professional must file a fee application. Accordingly, the fact that CDG was required to file a fee application, in accordance with sections 330 and 331, did not suggest to the Court that it would be reviewing CDG's requested compensation for reasonableness at the conclusion of the case.[1]

Upon consideration of all of the circumstances surrounding the entry of the final CDG retention order, the Court finds that the terms of CDG's employment, including the proposed compensation, were subject to extensive consideration by the parties and the Court. Therefore, the Court concludes that it considered fully the reasonableness of the proposed compensation and approved the compensation in advance of the services being rendered.

Having reached this conclusion, the Court cannot reduce the pre-approved fee without finding that CDG's employment "terms and conditions [were] improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." No party in this case has suggested that such developments exist.

CONCLUSION

For the reasons stated above, the Court finds that the final compensation requested

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[1] The Committee argues that the Court could not have pre-approved the restructuring fee because such a conclusion is contrary to the United States Trustee's policy that professionals' fees cannot be pre-approved without a specific reference to section 328 within the order. However, as the Court discussed above, as the bankruptcy court has actually reviewed the reasonableness of the compensation, section 328 does not require that the order contain a specific reference to section 328.

by CDG should be, and hereby is, approved. The objections filed by the Committee and the Reorganized Debtors are overruled. The Final Application for Compensation of Conway Del Genio, Gries & Co., LLC is hereby **GRANTED**.

CDG has requested permission to file a supplemental application for fees and expenses incurred in the course of defending against the objections to its fee application. The Court finds no reason why CDG should not be permitted to do so, subject to any party in interest's right to object to the fees.

IT IS SO ORDERED.

At Newnan, Georgia, this _____ day of September, 2005.

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W. HOMER DRAKE, JR.
UNITED STATES BANKRUPTCY JUDGE