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Lack of Transparency Challenges Claims Agent Sector

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What exactly is a claims agent today? And is the answer different today compared to what it was when the industry came into being in the 1980s? These are questions worthy of discussion.



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The claims management sector began in earnest in the 1980s during the ITEL bankruptcy case. It was in this early “mega-case” where the debtor set up its own computer system to take in and manage many thousands of claims. In effect, the debtor itself was responsible for its own claims management. This in-house solution where the debtor itself managed claims intake continued until the Eastern Airlines case in the Southern District of New York, at which point the clerk’s office halted a debtor’s self management of claims administration, marking the birth of what today is commonly known as the “claims agent.”

Retention of a claims agent, unlike case professionals, occurs under 28 U.S.C. §156(c), which Congress enacted in 1984 partially in response to the inability of the clerk of the bankruptcy court to properly staff the massive claims management work associated with a mega case. The ability to retain an outsourced agent of the clerk of the court, using this section of title 28 to do so, seemed to

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serve a multitude of purposes for both the overburdened and understaffed clerk of the court as well as the debtor. In short, claims agents came into existence to help assure a proper and efficient claims-administration process. What was likely not anticipated at the time, however, was how this effort spawned what today has become a major business opportunity for the dozen or so private and public firms who comprise this cottage industry.

It is submitted that the claims-management sector of the turnaround community has morphed in the 20 or so years since it came into existence to one that involves far more than the basics of noticing and claims intake.

Feature

While it is a sector few would dispute is critical to complex chapter 11 cases, it remains somewhat ill-defined in what its boundaries, if any, should be.



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In theory, there is a cost savings associated with using claims agents for the tasks with which they are charged. At the same time, however, the sector has become a big business with big dollars being earned, but at what cost to an estate, and with what oversight on how those dollars are

being expended by a debtor?

As one of the pioneers of this industry, having entered the sector 20 years ago, we thought it would be useful to look in the mirror and out the window to offer a critical analysis of what the claims-agent sector has become and, more importantly, to consider whether the time has come to establish boundaries, ethical mandates and oversight or regulation for claims agents. In a sector that earns untold (and undisclosed) millions of dollars every year, these are questions that must be posed if this piece of the restructuring process is to have any efficacy at all on a going-forward basis.¹

A Flawed Selection Process

Notwithstanding the fact that the majority of claims agents have similar systems and capabilities, the retention of claims agents in approximately 150 chapter 11 cases in 2008 has been dominated by two companies.² Why? In

2006, the Southern District of New York attempted to address this very issue when it established a “Protocol for the Employment of Claims Agents.” That protocol, designed to “ensure the use of competitive process in the selection of claims agents,” is an important first step to create balance in a sector where price analysis, competitive bidding and debtor input in the selection of a claims agent hardly exists.

The Southern District of New York protocol requires a debtor to obtain

¹ The views expressed herein are those of the authors only and not those of the ABI, ABI staff, ABI directors or Journal editors.

² This data was compiled from the actual court dockets of 149 cases where claims agents were retained in 2008. The same was then entered into into a database created and maintained by Donlin, Recano to monitor multiple data fields including the retentions of claims agents.

three bids from court-approved claims agents before selecting one. In addition, the debtor, under penalties of perjury and Fed. R. Bankr. 9011, must affirm that it “chose the claims agent after the review and competitive comparison of at least three proposals.” While this is good in theory, it has yet to work in practice and more importantly has not been followed, expanded or otherwise implemented in other districts (specifically the District of Delaware and the Northern District of Illinois) where the retention of a claims agent is a requirement in large complex cases.

In addition, the New York protocol lacks effective enforcement provisions of any meaning that would help create the competitive balance it seeks to achieve. For example, the debtor need not disclose what proposals it reviewed before selection of a claims agent, nor is it required to indicate why one claims agent has been selected over another. There are no price analysis provisions in it and no standards regarding what needs to be compared when reviewing the three proposals of approved claims agents. In essence, the protocol can easily be negated, allowing the selection process of a claims agent to remain more relationship-based than anything else.

With the vast majority of retentions in the sector being awarded to two firms, the protocol clearly has not served its intended purpose as a model for balance both in New York and elsewhere.

Today, the selection of a claims agent is driven more by relationships, particularly between the claims agent and key contacts at law firms. This in effect has become the protocol of who gets retained to serve in the semi-public capacity of agent of the clerk of the court.

This was not always the case, however, and in the early years of this industry sector the claims agent, like financial advisors, often had to bid for work in the purest sense, presenting itself directly to the debtor for consideration before being selected. In recent years, however, the debtor has had minimal input in the selection of its claims agent.

While the theory of what the Southern District of New York has attempted to create is right, what it highlights more than anything else is the need for oversight and regulation over a retention that is both critical to, yet different from, any other in a complex chapter 11 case.

The Basics vs. the Extras

Is the claims agent sector straightforward in what services it provides? Recent articles in trade publications such as the *Dow Jones Daily Bankruptcy Review* and *Global Turnaround* give some insight into this question. In articles that appeared in both of those publications, the claims agents interviewed discussed how the sector has changed. In a March 2008 article that appeared in *Global Turnaround*, for example, one claims agent defined traditional claims agents as those who handled paperwork, “but in the main they had little legal background and relied on antiquated methods.” Statements such as this intimate that the line between lawyer and claims agent has now blurred, and to be an effective claims administrator, one must have a legal background.

Moreover, statements such as this demonstrate an unresolved tension that exists in the claims-agent sector. If a claims agent is an agent of the clerk of the court and is being retained to perform services for the court under the direction of the clerk, should it not maintain a narrow role? While the answer to this question would seemingly be yes, the reality is that the sector continues to move into areas previously considered more proper for retained professionals.

Today, the claims agent is part agent of the clerk of the court, part consultant and part back office to a law firm. Is this, however, the role Congress intended this sector to serve when it enacted 28 U.S.C. §156(c)? From this claim’s agent’s perspective, we think not.

A Sector Self Defined

Once retained, who is responsible for keeping a claims agent in check? The question may seem obvious, but the answer is not so clear. The claims agent, unlike other case parties, is not considered a professional under the Bankruptcy Code. Thus, he or she does not have to adhere to the same standards as other professionals, nor does he or she have to be accountable for his or her fees the same way case professionals are mandated to account for their fees and expenses. It is a rare day indeed when a claims agent’s fees are questioned in earnest because there is no formal review process to create the accountability that exists everywhere else in a chapter 11 case.

This is a troubling issue for a variety of reasons. The claims and noticing

sector in 2008 has grown far beyond the basics of what it started as back in the 1980s. It is no longer a sector that just deals with volume noticing and claims management and intake issues. Recent entrants into the sector have taken it far afield of these traditional responsibilities. This translates into charges for an array of tasks performed without validation of whether they are a proper function of a claims agent. One need only review the price sheets of various claims agents (when they are filed with retention applications, which in many cases they are not) to highlight the questions raised.

Price sheets for claims agents today include everything from tech charges to data-storage fees as well as an array of consulting fees, which in some cases can go as high as \$325 per hour. Retainers often exceed six figures.

Because we start with the premise that a claims agent is supposed to manage claims and deal with mass noticing issues, the question is whether these fees are properly charged given the nature of the services they relate to and the lack of oversight over how they are performed. This drives home the need for oversight where little or none currently exists.

Lack of Checks and Balances

What role, if any, should the U.S. Trustee play with respect to the oversight of a claims agent? This remains wholly unclear. Following a review of the retention application for a claims agent, the Office of the U.S. Trustee effectively takes itself out of the process, especially since claims agents bill on a monthly basis as if they were ordinary-course vendors, not subject to any fee review process the way all other case parties are.

With limited accountability and no sector oversight, one can only hope that in the void in which the claims agent operates, undetectable inefficiencies and the broad latitude in services provided do not cost an estate thousands if not hundreds of thousands of dollars, effectively taking money away from creditors.

To drive the point home, one need only consider the following: Debtors are checked by creditors. Financial advisors conduct diligence to detect fraud or to determine value. Professionals are scrutinized by judges, and fee requests are reviewed and commented upon by the U.S. Trustee. Nowhere in this system of checks and balances, however,

has the claims agent been brought into the fold, leaving a sector that expends untold amounts to market and create relationships to garner lucrative work, ripe for abuse. Can a sector left wholly unregulated be trusted to police itself away from the temptations of abuse? Unfortunately, current history seems to suggest that in other business sectors, self regulation does not work.

Marketing Efforts of a Semi-public Entity

Are there ethical boundaries within which the claims agent must act when soliciting engagement opportunities? This may be one of the most interesting and important questions of all in the analysis of the claims agent sector, especially in light of the stepped-up marketing efforts claims agents have pursued in recent years.

Marketing has undoubtedly become a cornerstone of the way claims agents establish, maintain and enhance relationships, particularly with attorneys and law firms, for case assignments. This is relatively new to an industry that in the past was not known to be driven by such efforts the way that other industry players, such as financial advisors and investment bankers, have always used marketing as a vehicle to enhance their presence in the turnaround community.

While there is nothing wrong with marketing efforts to enhance awareness of a sector or company, there are ethical considerations that must be respected, especially given the uniqueness of what the claims agent represents compared to other industry players. A claims agent is arguably not a wholly private entity providing a service like any other. It is a sector created to serve as an arm of the federal government, and as such must at least be scrutinized for what it does to maintain relationships key to the selection process of a claims agent.

The question that arises here is where the line, if any, should be drawn regarding what a claims agent can be doing on the marketing front. While it is not suggested that the claims agent be subject to the strict ethical mandates of governmental employees and agencies, there must be some defined boundaries. Partially because there is minimal industry oversight, however, that line has not been defined. Recent entrants into the sector have pressed the issue further by ratcheting up the marketing game to unprecedented levels.

Although marketing efforts in the

claims-agent sector have become a mainstay, what those efforts are varies widely. The expenditure of marketing dollars in this sector, for example, has been used to host dinners or cocktail receptions, offer tickets to major sporting events, give gifts of varying value to key industry players or host a long weekend away.

The expenditure of marketing dollars in these varying ways highlights the issue of what limits, if any, a claims agent should be subject to in its marketing efforts. Is the line of propriety a dinner for 100 conference attendees, a gift of substantial value or a weekend away? More importantly, do these types of marketing efforts influence the selection process for a claims agent, and should they?

It is easy to see the issue here. Attorneys and consultants are treated to a wide spectrum of perks by different companies in the sector—all who want nothing more than case assignments worth a substantial amount in fees. Does this not fly in the face of efforts such as the Southern District of New York protocol, which is attempting to create a balance in the claims-agent sector? More importantly, does this not highlight why better oversight needs to exist in a sector that remains an island unto itself in an industry where every other person and entity representing someone is subject to some form of oversight or checks and balances? Finally, is there a higher ethical standard applicable to claims agents because of their semi-public role as agent of the clerk of the court?

Conclusion

In recent years the claims-agent sector has changed in dramatic ways. In those changes, some central issues have crystallized. First, it is a sector that has always existed without much oversight. Second, it has become big business to become a claims agent, a sector that is more competitive now than ever before. Finally, as the sector becomes more crowded, efforts to garner, if not monopolize, case assignments have become driven by unprecedented marketing efforts.

In this era of chapter 11 cases where credit is scant and case outcomes more uncertain than ever before, it is time to bridge the gap between claims agents and all other case parties. If a review of the sector shows it to be effective, balanced and serving its intended

purpose, that is one thing. If, however, the industry sector is challenged by lack of competitive bidding, debtor input in case assignments, fair billings, true understanding of fees charged and the role marketing efforts play in the overall scheme of things, then it needs to be looked at in ways that have been ignored for much too long. Such a review and analysis can only make this critical sector more viable, efficient and effective, benefiting both debtors and creditors alike.

Editor's Note: To view the Southern District of New York's "Protocol for the Employment of Claims Agents" referenced herein, please go to www.nysb.uscourts.gov/pdf/newClaimsAgentsProtocol.pdf. ■

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