UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

JUDGE PETER J. WALSH

824 MARKET STREET
WILMINGTON, DE 19801
(302) 252-2925

August 2, 2001

William H. Sudell, Jr.
Derek C. Abbott
Morris, Nichols, Arsht & Tunnell
1201 North Market Street
P.O. Box 1347
Wilmington, DE 19899-1347

Richard A. Chesley
Jones, Day, Reavis & Pogue
77 West Wacker
Chicago, Illinois 60601-1692

Attorney for Houlihan, Lokey, Howard & Zukin

Chaim J. Fortgang
Richard G. Mason
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019

Attorneys for the Official Committee of Unsecured Creditors of ICG Communications, Inc., et al.

Frank J. Perch, III
George M. Conway
Trial Attorneys
Office of the United States Trustee
J. Caleb Boggs Federal Bldg.
844 King Street
Wilmington, DE 19801

Attorneys for the United States Trustee

Re: In re: ICG Communications, Inc., et al.
Case No. 00-4238 (PJW)

Dear Counsel:

This is my ruling with respect to the remaining open issue related to the application of the Official Committee of Unsecured Creditors ("Committee") to retain Houlihan, Lokey, Howard & Zukin Capital, L.P. ("Houlihan Lokey") as financial advisor. (Doc. # 580). The U.S. Trustee filed an objection to the retention application. Prior to the hearing on June 21, 2001, the Committee and the U.S. Trustee resolved several of the points raised by the U.S. Trustee and the June 21, 2001 hearing was devoted to addressing the objections of the U.S. Trustee that (a) the monthly fee is excessive and (b) the retention should not have a nunc pro tunc effective date of December 1, 2000. At the conclusion of the June 21 hearing, I ruled that the monthly fee was appropriate under the circumstances of this case but I reserved judgment on the issue of the nunc pro tunc effective date. (Doc. # 814 June 21, 2001 hearing transcript). Subsequent to the hearing, Houlihan Lokey and the U.S. Trustee filed written submissions on addressing the remaining issue. For the reasons discussed below I will allow the retention effective as of January 1, 2001.

The Debtors' bankruptcy petition was filed on November 14, 2000. Immediately following the formation meeting of the Committee, the Committee advised Houlihan Lokey that it wished to retain them as investment advisors. The engagement was effective on or about December 1, 2000 and Houlihan Lokey immediately undertook substantial and continuous efforts on behalf of the

Committee. However, the retention application was not filed until March 29, 2001. According to the uncontested testimony of Allen Fragen ("Fragen"), a director of the financial restructuring group of Houlihan Lokey, the four month delay resulted from the long negotiating process between the Committee and Houlihan Lokey regarding the fee arrangement, both the monthly fee and the back-end fee. Initially Houlihan Lokey requested a $200,000 per month fee with a back-end fee equal to 1% of creditor recoveries. As finally concluded the engagement calls for $250,000 per month for the first four months and $175,000 per month thereafter with an aggregate minimum fee of $1,000,000, plus Houlihan Lokey's right to apply for an unspecified deferred fee subject to the Committee's right to take a position on that application and subject to court approval.

The parties are in agreement that the controlling case law authorities on nunc pro tunc professional retentions are Fanelli v. Hensley (In re Triangle Chemicals, Inc.), 697 F.2d 1280 (5th Cir. 1983); In re Arkansas Company, Inc., 798 F.2d 645 (3rd Cir. 1986) and F/S AirLease II, Inc. v. Simon, 844 F.2d 99 (3rd Cir. 1988). These three cases stand for the proposition that nunc pro tunc retention approvals should be limited to cases where extraordinary circumstances are present. The facts in those three cases are distinctly unlike the facts in the matter sub judice.

In Triangle Chemicals the attorney filed the petition on behalf of the debtor and immediately undertook to perform services on behalf of the debtor. No retention application was filed. Seven months into the case the attorney filed a fee application. The bankruptcy court denied the application, holding that there was no basis for allowing the compensation absent the court's authorization for the attorney's employment. The court of appeals stated that it was dealing with an issue of first impression: whether the bankruptcy court is bound by a per se rule not to allow compensation for attorneys fees in the absence of a prior court authorization of the retention or whether instead the court has some discretion upon proper showing and for good cause to enter an order nunc pro tunc. The Triangle Chemicals opinion reveals no facts as to the reason why the attorney did not file a retention application. The appellate court ruled that in the exercise of its equitable powers the bankruptcy court was authorized to permit a nunc pro tunc appointment under exceptional circumstances. The case was remanded to the bankruptcy court for it to determine in the exercise of its sound discretion whether the circumstances warranted nunc pro tunc retention.

In Arkansas Company the Third Circuit followed Triangle Chemicals in holding that bankruptcy courts may in extraordinary circumstances grant retroactive approval of professional employment. Arkansas Company involved the retention of counsel by

the unsecured creditors committee. Counsel for the committee rendered legal services to the committee for 13 months before discovering that it had failed to obtain the requisite court approval. The only explanation offered for the delay was "inadvertence". Counsel sought retroactive retention. It was denied by the bankruptcy court and the district court affirmed. The court of appeal affirmed the district court, ruling as follows:

> To summarize, we hold that retroactive approval of appointment of a professional may be granted by the bankruptcy court in its discretion but that it should grant such approval only under extraordinary circumstances. Such circumstances do not include the mere neglect of the professional who was in a position to file a timely application. ...[I]n exercising its discretion, the bankruptcy court must consider whether the particular circumstances in the case adequately excuse the failure to have sought prior approval. This will require consideration of factors such as whether the applicant or some other person bore responsibility for applying for approval; whether the applicant was under time pressure to begin service without approval; the amount of delay after the applicant learned that initial approval had not been granted; the extent to which compensation to the applicant will prejudice innocent third parties; and other relevant factors. 798 F.2d at 650.

In F/S AirLease II, the court found that extraordinary circumstances justifying nunc pro tunc approval of a broker's employment did not exist. In that case the broker had a pre-petition agreement with the debtor to attempt to effect a lease

with respect to one of the debtor's aircraft. The debtor filed its petition in August 1984. The broker continued his efforts through the months of September and October and in late October was able to finalize a lease agreement with a third party. In late November the court conducted a hearing on the debtor's motion to approve the lease transaction. The broker testified at the hearing regarding the lease. However, he had not yet sought appointment as a broker or the approval of the court for his services. Ten months after the petition date the broker filed an application with the court seeking an administrative expense payment pursuant to § 503. The bankruptcy court approved the retention nunc pro tunc and approved the fee request. On appeal the district court approved the retention nunc pro tunc but vacated the amount of the award, finding that the amount had been insufficiently substantiated. On appeal the court recited extensively from its Arkansas Company opinion and concluded that there were no extraordinary circumstances to support a nunc pro tunc appointment.

The facts regarding the delay in the filing of the retention application in the matter before me are quite different from those recited in the three cases summarized above. I quote at length Fragen's June 21, 2001 testimony as to why it took so long to get the retention application filed.

> Q. Mr. Fragen, what took so long to get the retention application filed from December 1st to March 29th?

A. ...We were actually negotiating with the entire Committee, which meant that you are negotiating with six individual creditors formal Committee. This retention, as you have identified, has some unusual language about our success fee, our deferred fee. This was a case that was filed at the height of the telecommunications uncertainty. I mean, there still is a tremendous amount of uncertainty in the market. No one was really sure what these companies would end up being worth. There was a significant constituency in the Creditors Committee that thought that putting too much of our fee in an incentive fee or deferred fee put too much of our compensation at risk, that no one really knew what these cases were going to turn out like, and they, given the significant experience we had in telecommunications, they wanted us to work for them.

There was a sub group of the Committee that thought that we should be having higher--[Tr. 15-16]

* * *

What was going on is the sub group of the Committee that thought that we should have a monthly oriented fee structure without a back end, and there was others that thought that we should have a back end, a more traditional fee structure than you are used to seeing.

There was significant disagreement amongst the Committee members, and, frankly, I take on faith we are going to reach an agreement with these people. It's never not happened that we haven't reached an agreement with them. It's not, I don't think of the clock ticking to do this negotiation, and I don't think of, I don't think the Committee members approached it that way either because so many people were interested in the negotiation from the Committee standpoint, they would constitute a Committee call to prepare a response for us back and forth. Those often took a week or two weeks to

constitute and prepare. The negotiation was really only back and forth three or four times. It just took the Committee that long to respond. And, so, you know, expeditiously as we could, we documented it and filed it.

Q. Let me ask you this: When did final resolution take place with respect to the engagement letter?

A. I would imagine it took place within a day or two of us actually filing the application.

Q. Was there a significant delay between the actual agreement being reached with Creditors' Committee and the filing of the application with --

A. No, there wasn't.

Q. You mentioned it took just a long time, logistically, to pull this together.

Why was that, based upon your experience?

A. Well, to begin with, it was December 1st when this was filed. So, as soon as, unless you reach an agreement in a week, you are not going to reach an agreement for a minimum of four weeks later than that because of the holidays. You just can't get people. And, so, you know, you have got that to start with.

Then, as I said, it took two or three rounds of negotiation, it was two or three weeks around to get the Committee constituted and to have Wachtell, you know, we couldn't spearhead it. It's not like I can call individual Committee members and conduct negotiations between me and the Committee members. That's totally inappropriate. It needs to be a Committee acting as a body through their counsel. I am relying on Wachtell to organize a call and go through the negotiation with the Committee, and it took

them, you know, as I say, approximately two weeks around.

Q. Now, during this entire period these negotiations were taking place, was Houlihan performing advisory services on behalf of the Creditors' Committee?

A. Absolutely. [Tr. 17-19]

* * *

Q. Was the step down fee that was agreed to heavily negotiated between you and Wachtell on behalf of the Committee and the Committee members?

A. It took us almost three months to negotiate it. [Tr. 23]

* * *

Q. What did that proposed engagement letter ask for?

A. I believe it for -- I believe it asked for $200,000 a month for the first four months, dropping down to 175,000 thereafter and structured a back end fee equal to one percent of creditor recoveries.

Q. So, the two differences between what was initially proposed and what was finally agreed to is 50,000 a month in the first four months and a change from a structured back end fee to an open-ended back end fee; is that correct?

A. That's correct. [Tr. 29]

Following the testimony and the arguments of counsel at the June 21 hearing I observed: "[I]t seems to me that if there is fault here in not having the application timely filed, I don't believe, on the record before me, that it was the fault of

Houlihan, Lokey, and based upon the record before me, I can conclude that the delay was caused by the inability of the parties to agree upon the terms of the engagement." (Tr. 53). The issue then, is whether these facts fall within the standard for nunc pro tunc relief established by the Third Circuit in Arkansas Company. While couching the standard in terms of "extraordinary circumstances," the Third Circuit's interpretation of the standard suggests a flexible approach which requires bankruptcy courts to consider the circumstances of each case in light of equitable factors. The following statements in the opinion suggest broad bankruptcy court discretion in the matter:

> We agree ... with the approach of those courts that limit the grant of retroactive approval to cases where prior approval would have been appropriate and the delay in seeking approval was due to hardship beyond the professional's control.
>
> * * *
>
> [I]n exercising its discretion, the bankruptcy court must consider whether the particular circumstances in the case adequately excuse the failure to have sought prior approval. This will require consideration of factors such as whether the applicant or some other person bore responsibility for applying for approval; whether the applicant was under time pressure to begin service without approval; the amount of delay after the applicant learned that initial approval had not been granted; the extent to which compensation to the applicant will prejudice innocent third parties; and other relevant factors.
>
> * * *

> In this case, the district court found that "the equities simply do not fall in appellant's favor." 55 B.R. at 386. The court correctly reasoned that retroactive approval should be limited to cases where the hardship is not of counsel's own making. 798 F.2d at 650.

Given the Arkansas Company court's interpretation of "extraordinary circumstances," and given the distinctly different circumstances here versus those in the three relevant cases discussed above, I believe the situation that Houlihan Lokey was dealing with warrants an equitable solution by allowing some nunc pro tunc relief. In my experience it is not uncommon for a creditors committee to take some time to reach agreement on the retention terms, including compensation arrangements, and this can often produce a 30 to 60 day delay between the engagement and the filing of the retention application. To require an immediate application filing could adversely impact on that negotiating process, particularly where, as here, the committee's effective role early in the case called for immediate professional assistance. Nevertheless, I am mindful of the Third Circuit's concern that should the bar be lowered to allow some lesser showing of cause the salutary requirement of promptly filing retention applications may be undermined. Consequently, in order that this ruling not send the wrong message to the professionals seeking retention, I will limit the nunc pro tunc effect to January 1, 2001, rather than December 1, 2000.

Counsel for Houlihan Lokey should present an order on notice.

Very truly yours,

/s/ Peter J. Walsh

Peter J. Walsh

PJW:ipm