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UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

In re WATTSHealth Foundation, Inc. dba UHP Healthcare, a California not-for-profit corporation, Debtor. Tax I.D. No. 95-2623688	Case No.: LA 05-22627 TD Chapter 11 **DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC** Date: September 6, 2007 Time: 11:00 a.m. Hon. Thomas B. Donovan Place: Roybal Federal Bldg. Courtroom 1345 255 E. Temple Street Los Angeles, CA 90012

TO THE HONORABLE THOMAS B. DONOVAN, UNITED STATES BANKRUPTCY JUDGE, APPLICANT, COUNSEL FOR THE DEBTOR, THE OFFICE OF THE UNITED STATES TRUSTEE, AND PARTIES REQUESTING SPECIAL NOTICE:

NOTICE IS HEREBY GIVEN that for the reasons contained herein, the Department of Managed Health Care ("Department") submits this Objection to the Final

Fee Application of Alvarez & Marsal, LLC ("A&M"), which was submitted to the Court on July 20, 2007, and requests a hearing on this matter.

NOTICE IS FURTHER GIVEN that pursuant to Local Bankruptcy Rule 9013-1(a)(7), any reply to the Objection shall be filed with the Court and served on counsel for the Department not later than seven (7) calendar days (not excluding Saturdays, Sundays, and legal holidays) prior to the hearing on the motion.

Dated: August 20, 2007

DEPARTMENT OF MANAGED HEALTH CARE

By: Linda Azzolino
for DEBRA L. DENTON
Assistant Chief Counsel
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MEMORANDUM OF POINTS AND AUTHORITIES

I.

INTRODUCTION

The Department respectfully submits this Objection to the A&M Final Fee Application based upon federal Bankruptcy Code §§ 330 and 331. The Department submits this Objection to the request for compensation in the amount of $754,928.00 by A&M based on the following:

1. The high percentage of total billable hours charged by partners;
2. The significant number of billable hours charged for internal meetings and conferences, analysis of internal memos, e-mails, and work-product, preparation in review of calendar;
3. Preparation of fee applications at a Partner/Associate rate;
4. Limited line item detail to support time and charges;
5. Charges for two or more senior staff to attend the same meetings;
6. Significant hourly rate increases for professionals during the term of the contract;
7. Use of higher level staff to perform ministerial functions, performances of services not otherwise defined in the applicable engagement letters; and
8. Lack of invoice details to support charges or direct expenses.

II.

BACKGROUND INFORMATION

A. WATTSHealth Foundation, Inc. is a Not-for-profit Health Plan Licensed by the Department of Managed Health Care.

WATTSHealth Foundation, Inc. operates under a license issued by the Department which regulates health care service plans in California pursuant to the Knox-Keene

Health Care Service Plan Act of 1975, as amended, Health and Safety Code §1340, et seq. ("the Knox-Keene Act") and the rules and regulations promulgated thereunder at Title 28, California Code of Regulations ("the Code of Regulations"). The Department is charged with the execution of the laws of this state relating to health care service plans and the health care service plan business. (Health and Saf. Code § 1341(a).) Until September 1, 2006, Watts arranged for the delivery of health care to approximately 90,000 members by contracting with various health care providers. In May of 2005, Watts filed for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court. As a Knox-Keene licensee, transactions carried out by Watts fall within the regulatory power of the Department and, pursuant to Article 11 of the Knox-Keene Act, any remaining charitable assets of the Debtor's estate are appropriately preserved for use for the public health and welfare of California citizens. As a result, it is incumbent upon the Department to ensure that the charitable assets of the Debtor remain minimally impacted by the bankruptcy proceeding and any excessive fee applications submitted by professionals. Thus, in conjunction with federal law and these bankruptcy proceedings, the Department has a vested interest through its regulatory and police powers to preserve the charitable assets that remain once the Debtor's creditors' are paid.

B. A&M is Employed by the Debtor for its Restructuring Services During the Bankruptcy Proceeding.

A&M was hired by the Debtor to provide restructuring advisory services to the Watts Board of Directors and to assist the company in the restructuring of its organization. (Foster Declaration, Exhibit D.) During the course of the bankruptcy proceeding, A&M billed approximately $5,026,394.00 in fees and reimbursement of $267,457 in expenses to the estate. The following fee applications, totaling the amount stated, were submitted to the Court for approval:

1. June 2005-August 2005: Application for Compensation, Filed 10/07/2005;

2. September 2005-December 2005: SECOND Interim Application of A&M, Filed 1/23/2006;

3. January 2006-April 2006: THIRD Interim application for Allowance and Payment of Compensation and Reimbursement of Expenses, Filed 5/23/2006;

4. May 2006-August 2006: FOURTH Interim Fee Application, Filed 11/9/2006;

5. September 2006-December 2006: FIFTH Interim Fee Application, Filed 3/12/2007; and

6. January 2007-May 2007: Application for Compensation/ Final Fee Application, Filed 7/20/2007.

When the Final Fee Application for A&M was submitted to the Court on July 20, 2007, the Department hired an outside consultant firm, pmpm® Consulting Group, Inc. ("pmpm®") to conduct a limited review of the fee applications submitted. Based upon pmpm's® findings during its review, the Department is respectfully submitting this Objection to the Final Fee Application of A&M.

III.

APPLICABLE AUTHORITY

All professional persons are required to file final fee applications and the motions for final fee awards shall contain all information required under Local Bankruptcy Rule 2016-1(a). (Local Bankr. Rule 2016-1(b)(1)-(2).) Any professional fees or expenses that were awarded as interim compensation under 11 U.S.C. §330 are subject to reconsideration at any time prior to the final award, for any reason. (Leichty v. Neary, 375 F.3d 854, 858 (9th Cir. 2004).) In the present case, the Department is requesting that the Court review the reasonableness of the charges assessed by A&M in this matter.

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A. The Bankruptcy Court has the Authority to Review and Reduce Fee Applications of Professionals.

The Bankruptcy Court (the "Court") is authorized, after notice and a hearing, to award professionals reasonable compensation for actual, necessary services rendered. (11 U.S.C. § 330(a).) The Court is also authorized to award less than the amount of compensation requested by the attorney or professional. (11 U.S.C. § 330(a)(2).)

The Court has broad discretion in determining the amount of attorneys' fees to award as compensation for services performed in connection with bankruptcy proceedings. (In re First Colonial Corp. of America, 544 F.2d 1291, 1298 (1977).) The Court looks to professionals seeking compensation under § 330 to exercise common sense and "billing judgment" and to make clear in their fee applications when justifying circumstances arise. (In re Jefsaba, Inc., 172 B.R. 786, 797 (Bankr. E.D. Pa. 1994).)

Congress has clearly designated to the United States Trustee ("UST") the discretion to assure that fee awards and expense reimbursements are reasonable. This delegation may, at first blush, appear exclusive. (28 U.S.C.A. § 586(a)(3)(A)(1993); see also Fed. R. Bankr. P. 2017 advisory comm. notes (West Supp. 1993); In re Jensen's Interiors, Inc., 132 Bankr. 105, 105-06 (E.D. Pa. 1991).) However, Congress' grant of authority to the UST to challenge fee petitions merely bestows the UST with standing and/or encourages the UST to do so. There is no negative implication that the bankruptcy court is without the power and duty to review fee applications independently when the UST does not object. (In re Busy Beaver Building Centers, Inc. 19 F.3d 833, 842 (3d Cir. 1994).) Further, the Court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested. (11 U.S.C. §330(a)(2).)

The Department is the state regulator which oversees California health care service plans. The Debtor is licensed as a health plan pursuant to the Knox-Keene Act and subject to oversight and regulation by the Department. Based upon the Department's

regulatory position and vested interest in maintaining the charitable estate, the Department undertook a review of A&M's final fee applications, including hiring pmpm® as consultants. After considerable review, it is the Department's position that the Final Fee Application submitted by A&M on July 20, 2007, fails to meet the reasonable fee standard and demonstrates a failure to use common sense and billing judgment. The fees charged by A&M are excessive, lack explanatory detail, and fail to adequately demonstrate that the services were necessary to the administration of this case.

B. <u>The Reasonableness of the Professional's Compensation Should be Reviewed.</u>

Section 330(a) of the Bankruptcy Code provides that a Bankruptcy Court may award, after notice and a hearing, a professional person employed under sections 327 or 1103 "reasonable compensation for the actual, necessary services rendered by the . . . professional person, or attorney. . ." and "reimbursement for actual, necessary expenses." (11 U.S.C. §330(a).) Section 330 also provides the following guidelines for the Court to consider with respect to determining the amount of compensation to be awarded:

1. The time spent on such services;
2. The rates charged for such services;
3. Whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
4. Whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
5. With respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

6. Whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title. (11 U.S.C. §330(a)(3).)

Section 330(a) also expressly prohibits the Court from allowing compensation for the "unnecessary duplication of services or services that were not reasonably likely to benefit the debtor's estate or necessary to the administration of the case." (11 U.S.C. § 330(a)(4)(A).)

1. Ministerial Tasks Performed by Professionals at a Professional Rate.

The Court scrutinizes whether the appropriate professional or para-professional is assigned to the various tasks performed, paying particular attention to the level of professional billing time viz a viz the complexity of the task being performed. The nature, extent, and complexity of the task at hand determines the level of professional or para-professional who should perform the task and, consequently, the reasonableness of the fees charged for the services. (In re Busy Beaver Building Centers, Inc., *supra*, 19 F.3d 833, 852-53.) Specifically, it is unreasonable for a senior attorney to perform routine tasks such as preparing a debtor's schedules and statements, drafting a simple motion, or coordinating exhibits for a trial. These are tasks that a junior associate or even a paralegal can adequately perform. Consequently, fees charged at a senior attorney's hourly rate for such services are unreasonable and should be reimbursed at a lower rate. (In re Jefsaba, Inc., *supra*, 172 B.R. 787, 796.)

In pmpm's® review of the Final Fee Application of A&M, there were numerous instances found where a senior staff member performed ministerial tasks and billed at a professional rate for such items as cleaning an office. It appears based on pmpm's® review of A&M's fee applications that A&M failed to utilize analysts and other para-professionals whenever possible, as the total hours billed by para-professionals account for approximately ten percent of all hours billed by A&M. (Declaration of Foster, p. 2,

and Exhibit C.) There were also numerous instances where pension plan work, which was outside the scope of A&M's letter of engagement, was done by professionals versus the Debtor's staff, who at the time had an accounting staff and a Chief Financial Officer capable of handling the matter. (Declaration of Foster, pp. 2-3, and Exhibit C and D.) Pmpm's® findings contradict the A&M Engagement Letter, which stated "A&M will use company staff as much as possible and/or practical to keep restructuring costs to a minimum." (Declaration of Foster, pp. 2-3, Exhibit D.)

Charges for such routine services as preparation of pleadings, conferences, attendance at routine hearings, negotiations, correspondence, telephone conversations and travel are generally held compensable at much lower rates than the maximum charged by an attorney, irrespective of the experience and competency of the attorney who performed them; likewise, the nature of preparation and rewriting of schedules is clearly clerical, which may be performed by an accountant instead of legal counsel and thus must be compensated at a lower rate. (In re Air Vermont, Inc., 43 B.R. 237 (B.C.D.C. Vt 1984).)

2. Multiple Professionals Billed for the Same Tasks.

Requests for fees under 11 U.S.C. § 330 will be reduced where compensation is sought for duplicative services in attorney conferences where: 1) no explanation is given as to why it was necessary to have two or more professionals working on the same activities; and 2) nothing in the file indicates that it was a particularly complex case with novel issues. (In re Pothoven, 84 B.R. 579 (1988, B.C. S.D. Iowa).) Only one attorney may charge for intra-office conferences under 11 U.S.C.S. § 330, unless explanation of each attorney's participation is given. (In re Wiedau's, Inc., 78 B.R. 904 (1987, B.C. S.D. Ill.).) Bankruptcy estates should not bear the costs of compensating under 11 U.S.C.S. §330 for each attorney present at intra-office conference unless counsel can show that the estate benefited from each attorney's special area of expertise; and absent a showing of the purpose of the conference and why the conference was essential to

efficient management of case, the court will not award full compensation to each attorney present at the conference. (In re Pothoven, *supra*, 84 B.R. 579.) If two or more professionals are billing time, they each should make a contribution, especially when more then one professional attends a hearing. (In re Jefsaba, Inc., *supra*, 172 B.R. 787, 801.)

In pmpm's® review of the Final Fee Application of A&M, there were numerous instances where A&M seeks compensation for multiple professionals to perform the same task. (See Declaration of Foster, p. 2, and Exhibit C.) One particular area of concern is the excessive amount of internal conferencing between two or more professionals, each of whom bills for this task. (*Id.*) Fees should also be reduced where multiple A&M professionals attended external or internal meetings, without reason stated as to why more than one professional was necessary.

Additionally, the application indicates that compensation is requested for the review of internal e-mails, memorandums, agendas, calendars, etc. Fees are not allowable under 11 U.S.C. § 330 for simply reading work product of another lawyer as a matter of interest. The review of these work product documents are compensable only if such review is required to form some kind of response or to perform a particular task in the case. (In re Wiedau's, Inc., *supra*, 78 B.R. 904.) In the present case, the lack of invoice detail prohibits a finding that such activities were justifiable and compensable.

3. The Time Spent by Professionals on Tasks is Not Reasonable.

Just as the hourly rates must be reasonable, so must be the time spent by the professionals on the various tasks. (11 U.S.C. § 330(a).) When a professional seeks to have his or her fees paid from the debtor's estate, the request for compensation should be based on detailed, contemporaneous time records that reveal enough information to enable the court to make an informed judgment about specific tasks and the time allotted thereto. (In re Hamilton Hardware Co., 11 B.R. 326, 4 C.B.C. 2d 699, (Bankr. E.D. Mich. 1981); In re Garland Corp. 8 B.R. 826, (Bankr. D. Mass. 1981).) In determining

the reasonableness of the amount of time expended, the Court draws on its experience and knowledge of time required for similar matters. (In re Jefsaba, Inc., *supra*, 172 B.R. 787, 798-99.) Time expended must also be commensurate with the anticipated benefit to the estate. Unproductive time will not be compensated. (*Id.*)

The review of the fee applications by pmpm® noted numerous instances where professionals were billing for reviewing the work product, e-mails, calendars, etc., of other professionals. (Declaration of Foster, p. 2.) The estate did not benefit from these activities and the reasonableness of the time spent on these types of ministerial tasks by professionals cannot be shown. Therefore, the time spent on these activities should be denied in its entirety or reduced to the appropriate rate of a para-professional or clerical staff.

4. Lack of Specificity and Detail in the Fee Application.

In order to be deemed sufficient, a professional's fee application should clearly identify, describe, and explain the services and expenses charged to the estate clearly so that the court is able to evaluate the reasonableness of the compensation requested. Professionals are required to substantiate the reasonableness of their time spent on a particular project through the submission of appropriate records. (In re Cenna's Fine Furniture, Inc., 109 B.R. 575 (E.D.N.Y. 1990); Southwestern Media, Inc., v. Rau, 708 F.2d 419 (9th Cir. 1983).) Incomplete and otherwise inadequate time records may result in an award of compensation in an amount less then the amount requested. (In re Wiedau's, Inc., *supra*, 78 B.R. 904; In re First Software Corp., 79 B.R. 108 (Bankr. D. Mass. 1987.) In this case, A&M failed to provide an adequate explanation for the time spent on many items for which compensation is being sought. The lack of invoice detail renders the review of the time spent and necessity of the services impossible. (Declaration of Foster, p. 2, and Exhibit C.)

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5. Compensation for Preparing Fee Applications Should be Reduced.

Although the Ninth Circuit allows for the compensation of fees to prepare the fee application, case law provides for the reduction of fees for this task. Activities in connection with fee applications that should be performed by administrative rather than legal staff should not be billed at attorney rates. (In re S.T.N. Enterprises, Inc., 70 B.R. 823 (2d Cir. 1985).) This applies to the level of other professionals, e.g. when an experienced professional does a clerk's work, he or she should be paid clerk's wages. (In re Vogue, 92 B.R. 717, 718 (Bankr. E.D. Mich. 1988).) According to the portions of A&M's billing statements regarding the preparation of the fee application; it appears that the Applicant billed clerical tasks at the senior or more experienced professional's rate. Additionally, none of the six interim fee applications filed by A&M with the Court contain a reduction in the rates requested for the preparation of fee applications. (Declaration of Foster, Exhibit C.) Compensation for preparation of the fee application should be billed at a reduced rate. (In re Jensen-Farley Pictures, Inc., 47 B.R. 557 (1985, B.C. D.C. Utah).)

The Court in In re First Colonial Corp. of America, *supra*, 544 F.2d 1291, added the spirit of economy as a factor to be considered in determining the reasonableness of fees. The Court stated that the spirit of economy requires that fee awards in bankruptcy cases be at the lower end of reasonableness in view of the fact that attorneys assisting in the administration of the estate are acting as officers of the court and should not be compensated as generously as they might be if privately employed. This spirit of economy is especially applicable and even more crucial given that the debtor is a not-for-profit corporation whose net charitable trust is directly impacted by the fees compensated. The size of the awards of professional fees directly affects the amount of residual assets available for return to the bankrupt and its shareholders upon the termination of the proceeding. (*Id.*) Any residual assets that remain after the conclusion

of the bankruptcy proceeding will be placed into a charitable trust to fulfill the Debtor's intended purpose in the underserved community in the Watts area.

6. Expense Reimbursement Should be Limited.

While § 330(a)(1)(B) authorizes reimbursement of expenses, it does not create an automatic entitlement to reimbursement. The determination of whether to allow reimbursement of expenses depends, in part, on whether the expenses are considered "overhead" charges, which are not reimbursable. Non-reimbursable overhead has been defined to include regular administrative and general expenses incident to the operation of a business that cannot be attributed to a particular client or cost. (In re Convent Guardian Corp., 103 B.R. 937 (Bankr. N.D. Ill. 1989).) The United States Trustee's Guide to Applications for Professional Compensation ("Fee Guide") explains that the billing format for expense. Specifically, "[e]xpenses. . . should be listed by category and month incurred. Unusual expense items or those in excess of $1,000.00, should include the date incurred; description; amount and explanation of need." According to pmpm's® findings, A&M is requesting reimbursement for over $44,000 in travel expenses due to lack of detail. (See Declaration of Foster, p.2 and Exhibit C.) Without sufficient detail to demonstrate that the travel expenses were actual and necessary, the expenses should not be awarded.

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IV.

CONCLUSION

For the foregoing reasons, the Department of Managed Health Care respectfully objects to the Final Fee Application of A&M and requests the Bankruptcy Court order an evidentiary hearing on this matter and for other such appropriate relief.

Dated: August 20, 2007

DEPARTMENT OF MANAGED HEALTH CARE

By: Linda Azzolini
for DEBRA L. DENTON
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PROOF OF SERVICE BY MAIL
(Code Civ. Proc. §§ 1012, 1013(a))

CASE NAME: **In re WATTSHealth Foundation, Inc., Debtor**
CASE NUMBER: **LA 05-22627 TD**
ENFORCEMENT MATTER NO.: **05-211**

I Michael R. Rouzer declare, I am employed in the County of Sacramento, California; I am over the age of 18 years, and not a party to the within action; my business address is 980 Ninth Street, Suite 500, Sacramento, California 95814-7243. I am readily familiar with my employer's business practice for collection and processing of correspondence for mailing with the United States Postal Service. On August 20, 2007, following ordinary business practice, I served the within:

DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC; DECLARATION OF RUSSELL D. FOSTER IN SUPPORT OF THE DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE PROPOSED FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC.

on the party/parties named below, by placing a true copy thereof, enclosed in a sealed envelope, for collection and mailing, with the United States Postal Service, where it would be deposited in the United States Postal Service that same day in the ordinary course of business, addressed as follows:

SEE ATTACHED SERVICE LIST

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on August 20, 2007, at Sacramento, California.

MICHAEL R. ROUZER
Legal Secretary

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PROOF OF SERVICE
(Code Civ. Proc. §§ 1012, 1013(a))

CASE NAME: **In re WATTSHealth Foundation, Inc., Debtor**
CASE NUMBER: **LA 05-22627 TD**
ENFORCEMENT MATTER NO.: **05-211**

I Keith E. Cook declare, I am employed in the County of Los Angeles, California; I am over the age of 18 years, and not a party to the within action; my business address is 320 West Fourth Street, Suite 880, Los Angeles, California 90013-1105. On August 20, 2007, following ordinary business practice, I served the within:

DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC; DECLARATION OF RUSSELL D. FOSTER IN SUPPORT OF THE DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE PROPOSED FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC.

on the party/parties named below, by personal service:

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633 W. 5th Street, 16th Floor
Los Angeles, CA 90071-2027

Joel Samuels
Sidley Austin, LLP
555 W. 5th Street, Suite 4000
Los Angeles, CA 90013-1010

Bradley A. Lang
Alvarez & Marsal
633 West Fifth Street, Suite 2560
Los Angeles, CA 90071

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on August 20, 2007, at Los Angeles, California.

KEITH E. COOK
Investigator

PROOF OF SERVICE
(Code Civ. Proc. §§ 1012, 1013(a))

CASE NAME: **In re WATTSHealth Foundation, Inc., Debtor**
CASE NUMBER: **LA 05-22627 TD**
ENFORCEMENT MATTER NO.: **05-211**

I Brenda Snowden declare, I am employed in the County of Los Angeles, California; I am over the age of 18 years, and not a party to the within action; my business address is 320 West Fourth Street, Suite 880, Los Angeles, California 90013-1105. On August 20, 2007, following ordinary business practice, I served the within:

DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC; DECLARATION OF RUSSELL D. FOSTER IN SUPPORT OF THE DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE PROPOSED FINAL FEE APPLICATION OF ALVAREZ & MARSAL, LLC.

on the party/parties named below, by personal service:

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Richard Diamond, Esq.
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Los Angeles, CA 90067

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on August 20, 2007, at Los Angeles, California.

BRENDA SNOWDEN
SISA

AMY L. DOBBERTEEN
Assistant Deputy Director, Bar No. 155111
DEBRA L. DENTON
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Attorneys for California Department of Managed Health Care

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

In re WATTS Health Foundation, Inc. dba UHP Healthcare, a California not-for-profit corporation, Debtor. Tax I.D. No. 95-2623688	Case No.: LA 05-22627-TD Chapter 11 **DECLARATION OF RUSSELL D. FOSTER IN SUPPORT OF THE DEPARTMENT OF MANAGED HEALTH CARE'S OBJECTION TO THE PROPOSED FINAL FEE APPLICATION OF ALVAREZ & MARSAL HEALTHCARE INDUSTRY GROUP, LLC.** **HEARING:** Date: September 6, 2007 Time: 11:00 a.m. Place: Roybal Federal Bldg. Courtroom 1345 255 E. Temple Street Los Angeles, CA 90012 **Exempt from Fees** **(Gov. Code § 6103)**

I, Russell D. Foster, declare that if called as a witness, I could and would testify to the following of which I have personal knowledge:

1. I am a Principal of pmpm® Consulting Group, Inc. ("*pmpm*®"), a health care consulting firm located in Sacramento, California. I have more than thirty years of health care experience in the managed care field. The California Department of Managed Health Care ("DMHC") engaged pmpm® to perform a limited review of final fee applications, previously submitted to the Bankruptcy Court for payment of services rendered, by the following vendor: Alvarez & Marsal Healthcare Industry Group, LLC ("Alvarez & Marsal").

2. *pmpm's*® limited review of documents included a test check of selected fee applications submitted to the Bankruptcy Court between June 2005 and May 2007 by Alvarez & Marsal.

3. During the course of *pmpm's*® review, senior staff performed a review of the sixth application of the aforementioned professional. Attached as Exhibit A is a true and correct copy of *pmpm's* ® Fee Application Summary.

4. The following issues were identified during the course of *pmpm's*® review:

a) A disproportionate percentage of total billable hours charged by partners and associates versus para-professionals. Attached as Exhibit B is a true and correct copy of *pmpm's* ® Summary of Billable Hours by Job Title – Selected Vendors;

b) Attached as Exhibit C is a true and correct copy of *pmpm's* ® analysis of inappropriate billing by senior staff including the following issues: A significant number of billable hours charged for partner-to-partner and partner-to-associate meetings and conferences, analysis of internal memorandums, e-mails and work products, preparation and review of calendars and preparation of fee applications; Charges for two or more partners/directors and/or senior staff to attend the same meeting(s); Lack of invoice details to support charges for direct expenses; Use of higher paid staff to perform ministerial or lower level functions more appropriately delegated to paralegals and analyst level staff; and Performance of services not otherwise defined in the applicable engagement letter or

amendment(s). Attached as Exhibit D are true and correct copies of the Engagement Letter between Alvarez and Marsal and Watts Health Foundation, Inc., dated June 3, 2005 and amended Letter Alvarez & Marsal Agreement, dated July 19, 2005.

c) Limited line-item detail to support time and charges;

d) Hourly rate increases between calendar years that exceeded the annual Consumer Price Index ("CPI") inflationary rate adjustment. Attached as Exhibit E is a true and correct copy of *pmpm's* ® analysis of Overpayment Due to Inappropriate Rate Increases. Attached as Exhibit F is a true and correct copy of *pmpm's* ® Hourly Rate Trend; and

5. Based on the results of *pmpm's* ® analysis of this professional's sixth fee application, with extrapolation to the other five (5) fee applications previously submitted, there are potential recoveries of $708,485.00, plus $46,444.00 in direct expenses not sufficiently detailed. Adjustments to fees are comprised of $352,977.00 for hourly rate adjustments and $355,508.00 for work hour adjustments.

6. The hourly rate adjustments are comprised of rate increases greater than the CPI inflationary rate adjustment and hourly rate adjustments for partners and other high hourly rate employees for preparation of fee applications to a para-professional rate.

7. The work hour adjustments include the following: (a) reducing fees for multiple professionals of Marsal and Alvarez attending external or internal meetings, without a reason stated why more than one representative was needed. In these situations, work hour adjustments were made to include only the most senior professional fee; (b) reducing fees for time charged without adequate description of the work performed; (c) unreasonable charges (including an adjustment of $2,438.00 for 6.5 hours to clean out an office at $375 per hour); and, (d) a $150,898.00 work adjustment for services performed relating to oversight of the pension and employee benefit plan audits that appeared to be outside of the scope of the Alvarez & Marsal

engagement letter and did not appear to be work that was approved by the Debtor's Board of Directors.

8. Additionally, the pension work performed by Alvarez & Marsal is normally performed by health plan staff and the Debtor had a full accounting staff that included a CFO. If the hours for this work are allowed, the rate charged should be at a maximum of an analyst rate.

9. Alvarez & Marsal had a high percentage of total billable hours charged by partners and associates versus para-professionals. The hours charged by Alvarez & Marsal were broken down as follows: (a) 59% Directors, Senior Directors and Managing Directors; (b) 31% for Associates; and (c) 10% for Analysts, one of whom was promoted to an Associate during this time period with an increased billing rate of $100.00 an hour. After the second fee application was filed, Alvarez & Marsal essentially stopped using analysts on this case.

10. Attached as Exhibit G is a true and correct copy of the summary of adjustments to the fee applications submitted by Alvarez & Marsal, LLC, FTI Consulting, Inc., Sidley Austin Brown & Wood LLP, and Stutman, Triester & Glatt.

I declare, under penalty of perjury under the laws of the State of California, that the above is true and correct. Executed this 20th day of August, 2007, in Sacramento, California.

RUSSELL D. FOSTER
Declarant