

Construing “Substantial Contribution” Under Section 503(b)(3)(D)

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In keeping with the courts’ narrow construction of what constitutes “substantial contribution” in a chapter 11 case, an Ohio bankruptcy court in *In re AmFin Financial Corp.*, 2012 WL 652018 (Bankr. N.D. Ohio Feb. 28, 2012), denied administrative-expense priority to the fees and expenses of the holders of approximately \$100 million in senior notes (the “Senior Noteholders”) issued by debtor AmFin Financial Corporation (“AFC”). According to the court, “[T]he efforts by the Senior Noteholders to settle their own claims are not properly characterized as a substantial contribution to the case.”

Administrative-Expense Priority for Making a “Substantial Contribution”

Section 503(b)(3)(D) of the Bankruptcy Code grants administrative-expense priority for the “actual, necessary expenses” incurred by a creditor, among other entities, in making a “substantial contribution” in a case under chapter 11. In addition, section 503(b)(4) of the Bankruptcy Code grants administrative-expense priority for “reasonable compensation for professional services rendered by an attorney . . . of an entity whose expense is allowable under” section 503(b)(3)(D) and “reimbursement for actual, necessary expenses incurred by such attorney.” As explained by the *AmFin* court, these provisions are an “accommodation between the two objectives of encouraging meaningful creditor participation in the reorganization process and keeping administrative expenses and fees at a minimum to maximize the estate for creditors.”

The Bankruptcy Code neither defines “substantial contribution” nor sets forth criteria to be used in determining whether a substantial contribution has been made in a chapter 11 case. The issue,

therefore, of whether a creditor has made a “substantial contribution” is a question of fact, with the moving party bearing the burden of proof. Most courts narrowly construe what constitutes a “substantial contribution” in a chapter 11 case, and most have taken the position that substantial-contribution claims, like other section 503(b) claims, should be strictly limited. The principal test is that there must be actual and demonstrable benefit to the estate and creditors.

The Facts

On the day that AFC—a bank holding company whose banking subsidiary, AmTrust Bank, would shortly be seized by the U.S. Office of Thrift Supervision (“OTS”)—and its affiliated debtors sought chapter 11 protection in Ohio, the debtors filed an adversary proceeding against the Senior Noteholders seeking to avoid approximately \$12 million in payments, guaranties, and liens as preferential and constructively fraudulent transfers. Shortly afterward, OTS took control of AmTrust Bank and appointed the Federal Deposit Insurance Corporation (the “FDIC”) as receiver.

The FDIC has two major disputes with the debtors, both of which evolved into litigation before the district court and have yet to be fully resolved. The first dispute revolves around the FDIC’s contention that it has claims against AFC in excess of \$2 billion, all or substantially all of which is entitled to priority pursuant to section 365(o) of the Bankruptcy Code on the basis of AFC’s alleged commitment to maintain the capital of AmTrust Bank. The second dispute involves a 2009 tax refund of approximately \$194 million that the FDIC claims is its property. The outcome of the section 365(o) litigation and, to a lesser extent, the tax-refund litigation will determine whether the debtors are able to make distributions to unsecured creditors under a chapter 11 plan.

The Senior Noteholders' Purported "Substantial Contribution" to the Cases

The Senior Noteholders and the debtors resolved their disputes pursuant to a settlement embodied in the debtors' now confirmed chapter 11 plan. The settlement provides, among other things, that \$2 million which would otherwise have been distributed to the Senior Noteholders under the plan will instead be distributed to the holders of other general unsecured claims on a pro rata basis. The \$2 million redistribution resolved the debtors' approximately \$12 million claim that was the subject of the adversary proceeding against the Senior Noteholders.

The Senior Noteholders moved for allowance and payment of \$950,000 of fees and expenses incurred in connection with the chapter 11 cases as a substantial-contribution claim pursuant to sections 503(b)(3)(D) and 503(b)(4). As evidence of their substantial contribution, the Senior Noteholders pointed to: (i) their decision to settle the adversary proceeding rather than proceed with litigation that would have reduced the amount of funds available to other creditors; (ii) assistance they provided in developing a defense strategy in the section 365(o) litigation and tax-refund litigation; (iii) their active involvement in responding to discovery in the section 365(o) litigation; and (iv) their agreement to the \$2 million redistribution, which the Senior Noteholders argued lowered their payment priority to the direct benefit of the estates' other creditors.

As part of the settlement, the debtors agreed to support the Senior Noteholders' request for a substantial-contribution claim of up to \$950,000. The FDIC and the U.S. Trustee, however, objected to the request, arguing that the Senior Noteholders' actions were taken only in furtherance of their own self-interest and duplicated the efforts of the debtors' professionals.

The Court Disallows the Substantial-Contribution Claim

The bankruptcy court, siding with the FDIC and the U.S. Trustee, denied the Senior Noteholders' motion in its entirety. The court applauded the Senior Noteholders' decision to settle their disputes with the debtors, stating that their "outstanding cooperation" helped the cases to proceed smoothly and that their counsel "acted with the utmost professionalism." However, the court explained that "[w]hile the settlement spared the estates and other creditors from the expense and inconvenience of litigation, this is true of any settlement reached." According to the court, agreeing to compromise the adversary proceeding for \$2 million did "not establish that the settlement benefitted [sic] the estate beyond the benefit that accompanies any settlement; i.e. resolution of issues without expending more time and money." Accordingly, the court held that the efforts by the Senior Noteholders to settle their own claims were not properly characterized as a substantial contribution to the cases.

The court also did not find that the Senior Noteholders made a substantial contribution to the cases by their participation in the section 365(o) litigation and tax-refund litigation. According to the court, the Senior Noteholders' efforts in responding to discovery requests from the FDIC did not benefit any party, much less constitute a substantial contribution, where the FDIC did not use any of the information it obtained from the Senior Noteholders. In addition, the court determined that any assistance provided by the Senior Noteholders in connection with the section 365(o) litigation and tax-refund litigation was duplicative of the efforts of the debtors' counsel, who had the responsibility of defending against the claims asserted by the FDIC. Accordingly, the court held that the Senior Noteholders' assistance with the section 365(o) litigation and tax-refund

litigation did not constitute a substantial contribution and, as such, denied the Senior Noteholders' motion.

Outlook

The court's decision regarding the Senior Noteholders' participation in the section 365(o) litigation might have been different had the Senior Noteholders presented more evidence to support their claim. The court noted at the outset of its opinion that the Senior Noteholders did not request an evidentiary hearing on their motion. Later, the court noted that "[o]n the record before it," the court could not conclude that the Senior Noteholders proved a substantial contribution to the cases within the meaning of section 503(b)(3)(D). In particular, the court explained that, although the Senior Noteholders' claim that they had made a substantial contribution in the section 365(o) litigation was "more promising," there was "insufficient evidence to prove this point." Thus, it is possible that, had the Senior Noteholders presented additional evidence, at least some portion of their \$950,000 claim might have been granted administrative-expense priority pursuant to sections 503(b)(3)(D) and 503(b)(4).

The *AmFin* court's decision—based on the limited record before it—is in keeping with the courts' narrow construction of "substantial contribution" claims and is yet another reminder to creditors of the significant evidentiary burden they bear should they seek administrative-expense priority for their fees and expenses, even in cases where the debtor supports the request.