Getting Fees Paid by the Chapter 11 Estate Without Proving Substantial Contribution?

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Section 503(b) of the Bankruptcy Code provides that the allowed administrative expenses of a bankruptcy estate shall include fees and expenses incurred by creditors, indenture trustees, and certain non-estate-retained professionals who make a "substantial contribution" in a chapter 9 or chapter 11 case. This is certainly the most frequently used provision under which such compensation is sought, but is it the exclusive method for such payment?

Despite vociferous objections from the United States Trustee (the "UST") in the Southern District of New York, courts have recognized an alternative method for obtaining payment from the debtor's estate of certain fees. Unlike under the more onerous "substantial contribution" test of section 503(b), an applicant may be awarded fees under a plan subject only to a "reasonableness" test set forth in section 1129(a)(4) of the Bankruptcy Code. Indeed, courts have concluded that sections 503(b) and 1129(a)(4) provide alternative methods for obtaining such relief and are not mutually exclusive.

The Battle Between Sections 503(b) and 1129(a)(4) of the Bankruptcy Code

Whether a party has made a "substantial contribution" is a question of fact that imposes the burden of proof on the applicant to show by a preponderance of the evidence that the services it rendered provided a substantial benefit to the estate. *In re Hooker Invs., Inc.*, 188 B.R. 117, 120 (S.D.N.Y. 1995); *In re Best Prods. Co.*, 173 B.R. 862, 865 (Bankr. S.D.N.Y. 1994). Active participation alone is insufficient; there must be a substantial net benefit. *In re Granite Partners,*

L.P., 213 B.R. 440, 445–46 (Bankr. S.D.N.Y. 1997). Substantial contribution provisions are narrowly construed. *Id.* at 445 (need to "discourage mushrooming expenses" and "do not change the basic rule that the attorney must look to his own client for payment"). Creditors face an especially difficult burden in passing the substantial contribution test since "they are presumed to act primarily for their own interests." *In re Dana Corp.*, 390 B.R. 100, 108 (Bankr. S.D.N.Y. 2008); *Granite Partners*, 213 B.R. at 446. Moreover, "[e]fforts undertaken by creditors solely to further their own self interest are not compensable under section 503(b)" and "services calculated primarily to benefit the client do not justify an award even if they also confer an indirect benefit on the estate." *Id.* In the majority of cases where courts have allowed creditors substantial contribution claims under section 503(b)(3), courts have found that the creditor played a *leadership role* that normally would be expected of an estate-compensated professional, *but was not so performed*. *See*, *e.g.*, *Granite Partners*, 213 B.R. at 446–47.

An applicant may, however, be able to recover certain fees and expenses from the estate without establishing that it provided a "substantial contribution." Section 1123(b) of the Bankruptcy Code provides that a plan "may" include certain types of provisions. The list of provisions in section 1123(b) is voluntary, and a plan proponent has discretion to tailor a plan to the specific needs of the case. In particular, section 1123(b)(6) provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]."

Section 1129(a)(4) of the Bankruptcy Code establishes a "reasonableness" standard for payments that are made pursuant to a chapter 11 plan. It provides that the bankruptcy court "shall" confirm a plan only if the following requirement is satisfied:

> Any payment made or to be made by the proponent [or] by the debtor . . . for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

Taken together, sections 1123(b)(6) and 1129(a)(4) authorize a plan proponent to include in its plan a provision for the payment of fees and expenses of certain parties and authorize the court to approve the payments as part of the plan, provided that they are "reasonable."

Current Status of the Case Law

The only published opinions addressing the payment of fees relying on sections 1123(b)(6) and 1129(a)(4) have been issued by bankruptcy courts in the Southern District of New York. In each case, the UST objected to payment of fees under any provision of the Bankruptcy Code other than section 503(b). The arguments posited by the UST can be summarized as follows: (i) as a matter of statutory construction, the specific provisions of section 503(b) supersede the more general provisions of section 1129(a)(4); otherwise, section 503(b) would be superfluous; and (ii) compensation under the reasonableness standard of section 1129(a)(4) without satisfying the elements of section 503(b) is "inconsistent" with the limitations of section 503, which would render section 1123(b)(6) inapplicable by its own terms.

In each of the *Adelphia*, *Lehman*, and *American Airlines* cases, the courts held that section 503(b) is not the exclusive means for payment of creditors' and/or indenture trustees' fees and expenses and that such payments were authorized by section 1123(b)(6), subject to the section 1129(a)(4) reasonableness standard. Beginning with Judge Gerber in *Adelphia*, and followed by Judge Peck in *Lehman* and, most recently, by Judge Lane in *American Airlines*, the courts implicitly or

explicitly found that there is no conflict or inconsistency between section 1129(a)(4) and section 503(b) because section 503(b) is a nonconsensual mechanism for payment of fees and expenses, whereas a plan provision is a consensual mechanism for payment of fees and expenses. *See In re Adelphia Commc'ns Corp.*, 441 B.R. 6, 12 (Bankr. S.D.N.Y. 2010); *In re Lehman Brothers Holdings Inc.*, 487 B.R. 181, 191–92 (Bankr. S.D.N.Y. 2013); *In re AMR Corp.*, 497 B.R. 690, 694–96 (Bankr. S.D.N.Y. 2013).

In *Adelphia*, 14 ad hoc committees and certain individual creditors sought approximately $88 million in legal fees and expenses. The parties had ended their intercreditor disputes with a global settlement that included a plan provision allowing the applicants to receive payment of their reasonable fees incurred during the course of the cases.

In what appears to have been a case of first impression, Judge Gerber was asked to determine whether it was permissible to approve such payments pursuant to a plan provision and the reasonableness standard of section 1129(a)(4), as distinguished from the substantial contribution test of section 503(b). The UST objected on the ground that a plan could not provide for payment of these parties absent a substantial contribution finding.

The court first analyzed whether the "substantial contribution" standard was the only basis for authorizing the payment of such fees. Reading the plain language of section 503(b), the court concluded that section 503(b) "does not provide, in words or substance, that it is the only way by which fees of this character may be absorbed by an estate." Thus, the court was "free to look to

other provisions of the Code that might also authorize a payment." Accordingly, the court looked to sections 1123(b) and 1129(a)(4).

In particular, the court looked to section 1123(b)(6), which provides that a plan may include any provision "not inconsistent" with applicable provisions of the Bankruptcy Code. Because the court had concluded that section 503(b) was not the exclusive authority for the payment of non-estate-retained professionals' fees and expenses, it reasoned that the payment of such fees and expenses pursuant to a plan was "not inconsistent" with section 503(b). The court ruled that a plan could include a provision to pay professionals for ad hoc committees and individual creditors without a showing of substantial contribution. The court did stress, however, that section 1129(a)(4) imposes a reasonableness requirement on the payment of any fees under a plan.

Although section 503(b) of the Bankruptcy Code provides for the payment of fees and expenses for an official creditors' committee, since the 2005 amendments to the Bankruptcy Code, section 503(b) does not expressly permit individual committee members to seek reimbursement of professional fees for services rendered by an attorney or an accountant. In *Lehman*, the plan provided for the payment of approximately $26 million in professional fees for individual committee members' attorneys' fees, subject only to the reasonableness standard of section 1129(a)(4). The UST objected on the basis that the plan provision attempted to circumvent the Bankruptcy Code's restrictions on administrative expense treatment for professional compensation claims.

Noting the "lopsided affirmative vote by a vast majority of accepting creditors," the *Lehman* court appeared reluctant to disrupt the heavily negotiated terms of a multibillion-dollar plan for a fee dispute of this size. Ultimately, Judge Peck followed the reasoning in *Adelphia* and concluded that such payments under a plan were proper, provided that the payments were reasonable and not inconsistent with applicable provisions of the Bankruptcy Code. The court further found that the payments were indeed not inconsistent with section 503(b). Specifically, the court wrote that "[s]ection 503(b) is not a straitjacket, and the provisions of that section that directly govern the allowance of administrative claims do not control the plan process and are not inconsistent with [] the more liberal treatment provided in" a plan. Thus, the court concluded that the broad language of sections 1123(b)(6) and 1129(a)(4) allowed members of a creditors' committee to bargain for their fees to be paid under a chapter 11 plan without meeting the requirements of section 503(b). The decision is currently on appeal before the U.S. District Court for the Southern District of New York. *See In re Lehman Brothers Holdings, Inc.*, No. 13-cv-02211-RJS (S.D.N.Y.).

In *American Airlines*, the debtors' plan also provided for the payment of the professional fees of individual creditors' committee members pursuant to the section 1129(a)(4) reasonableness standard. As in *Adelphia* and *Lehman*, the UST objected on the ground that professional fees not explicitly authorized by section 503(b) could not be paid. Judge Lane found the rulings in *Adelphia* and *Lehman* persuasive and reached the same conclusion: that fees are permissible when proposed and approved in a consensual plan. The judge specifically noted that section 503(b): (i) provides a creditor with an affirmative right to a claim whether or not a debtor agrees to such payment, provided that the creditor meets the standards set forth therein; and

(ii) does not contain prohibitive or restrictive language and thus permits fees paid pursuant to a reasonableness standard under sections 1123(b)(6) and 1129(a)(4) if such provision is proposed and approved through a consensual plan.

Notably, there are no published opinions in the District of Delaware (or any other jurisdiction outside the Southern District of New York) that address the section 1129(a)(4) versus section 503(b) issue. However, there are several instances of plans in Delaware incorporating a fee provision pursuant to the section 1129(a)(4) reasonableness standard that have been confirmed without objection from the Delaware UST. *See*, *e.g.*, *In re Tribune Co.*, No. 08-13141 (KJC) (Bankr. D. Del.), ECF No. 11747, 12074; *In re Amicus Wind Down Corp. (Friendly's Ice Cream)*, No. 11-13167 (KG) (Bankr. D. Del.), ECF No. 948, 1123; *In re Rotech Healthcare Inc.*, No. 13-10741 (PJW) (Bankr. D. Del.), ECF No. 512, 1007.

Is the Adelphia Fee Decision and Its Progeny as "Radical" as the UST Feared?

Courts that have addressed the issue have found a way to reconcile sections 1129(a)(4) and 503(b) under the appropriate circumstances. Significant leeway is granted to plan proponents under section 1123(b)(6) to include in plans any appropriate provision not inconsistent with the applicable provisions of the Bankruptcy Code, and courts are granted authority and discretion to approve payments in connection with a plan, subject to the reasonableness standard of section 1129(a)(4).

The UST Executive Office authored an article immediately following the *Adelphia* decision which suggested that the decision would set troubling precedent. *See* John Sheahan, *You Support*

My Plan, I'll Pay Your Attorneys: Adelphia*'s Troubling Precedent*, AM. BANKR. INST. J. 24 (May 2012), *available at* http://www.justice.gov/ust/eo/public_affairs/articles/docs/2012/abi_201205.pdf (all websites herein last visited on Mar. 19, 2014). In that article and in its now numerous objections filed in bankruptcy cases pending in the Southern District of New York, the UST argued that *Adelphia* would lead to a parade of horrors, including: (i) use of section 1129(a)(4) as a vehicle for fraud or abuse and illegitimate settlements entered into in exchange for the withdrawal of a plan objection or a competing plan, even asserting that a promise to pay attorneys' fees could induce a committee member to violate its fiduciary duty to its constituency or an attorney to violate a duty to a client or to cover up wrongdoing; (ii) the attempts of creative attorneys to bypass section 330 as the exclusive vehicle for paying professionals retained by the estate; (iii) the fact that payment of administrative expenses would be subject to two entirely different standards, depending on whether the plan proponent (typically the debtor) was aligned with the applicant; and (iv) possible attempts of plan proponents to evade other specific limitations of section 503, including the section 503(b)(7) cap on damage claims under previously assumed leases or the section 503(b)(4) exclusion of payment of attorneys who represent individual committee members. In the three years since the *Adelphia* decision, however, it does not appear that the UST's dire prognostications have come to pass.

Conclusion

Although reliance on section 1129(a)(4) for payment of fees may not arise in the typical case, it is important for creditors and interested parties to know that the substantial contribution provision of section 503(b) is not the only avenue for approval of their fees. Such parties should consider whether it would be appropriate to seek a plan provision for the payment of their fees

under the reasonableness standard of section 1129(a)(4). If a party secures a provision for payment of fees in a plan which is ultimately confirmed (particularly in cases where there is overwhelming creditor support for the plan), that party may be relieved of the burden of proving substantial contribution. In cases where the substantial contribution test might not otherwise be met, the section 1129(a)(4) alternative can make the difference between obtaining and forgoing payment of fees from the estate.

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