



# Ethics & Professional Compensation Committee

## ABI Committee News

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### [Adelphia Decision Permits Reimbursement of Distressed Debt Investors' Non-Fiduciary Professional Fees](#)

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On November 18, 2010, Judge Gerber of the Southern District of New York Bankruptcy Court issued a decision on payment of non-fiduciary professional fees in *In re Adelphia Communications Corp.* [1] The Court allowed a number of distressed investors to be reimbursed for legal fees and other expenditures spent in competing for larger recoveries from the estate. In the Chapter 11 cases, 14 *ad hoc* committees and individual creditors sought reimbursement under a provision of the Debtors' confirmed and effective Chapter 11 Plan. The total fees requested by the Applicants, the overwhelming majority of whom were distressed debt investors, totaled \$88 million. The Fee Provision authorized payment of the Fees subject only to reasonableness, without requiring the Applicants to demonstrate a "substantial contribution" to the case under §503(b)(3)(D) of the Bankruptcy Code.

Normally, individual creditors and *ad hoc* committees must demonstrate that they made a "substantial contribution" to the debtors' cases in order to be eligible for reimbursement of their fees and expenses pursuant to Code §503(b)(3)(D). The Code does not define "substantial contribution." Instead, courts employ various tests

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to gauge whether a creditor made a substantial contribution. In the Second Circuit, like other circuits, the standard to prove substantial contribution is demanding. "Compensation is limited to those extraordinary actions 'that foster and enhance, rather than retard or interrupt the progress of reorganization.'" [2]

The Court considered the propriety of the Plan's fee provision as a matter of first impression. Judge Gerber found that an agreement embodied in the Plan could permit the creditors to avoid the onerous standard under §503(b)(3)(D). Having decided that such an agreement was enforceable, the Court considered whether the requested fees were reasonable. According to the standard set forth in the Plan, such fees, if reasonable, were reimbursable even if incurred in resolving intercreditor disputes because such resolution was critical to confirmation of the Plan.

#### **A. Why did the standard of substantial contribution not apply?**

The Court found that the Plan's fee provision was permissible. In the decision, Judge Gerber cautioned that restraint must be exercised in declaring plan provisions unenforceable based on anything short of bankruptcy case law, nonbankruptcy statutory or case law, or unmistakable public policy concerns. Judge Gerber first found that §§503(b)(3)(D) and 503(b)(4) provide express but not exclusive authority for the payment of non-fiduciary creditor or equity security holders' fees. The Court found that other provisions of the Code, like §1129(a), could also allow a debtor to agree to payment of such fees because it lists requirements that need to be satisfied to secure confirmation and expressly contemplates that payments may be made in connection with a confirmed plan, as long as any such payments are approved as reasonable by the court. [3]

Next, the Court considered §§1123(a) and (b), which set forth what a reorganization plan must contain and also what is permissible to include in a plan. In the latter provision, the Code states that a plan "may...include any other *appropriate* provision not inconsistent with the applicable provisions of this title." [4] Therefore, the Court inquired whether the fee provision was "appropriate." Although the Court stated that "the case law is thin, and insufficiently on point," the decision noted that courts have rarely found plan provisions to be impermissible because they were not "appropriate" within the meaning of §1123(b)(6) and that courts had only done so where the provisions in question were violative of non-bankruptcy federal statutory law or existing case law. [5]

The Court also considered whether a strong public policy might make the plan provision not "appropriate." The Court found that payment of the fees of distressed debt investors might constitute a public policy concern because while distressed debt investors provide critical liquidity, they "don't pay for the costs and burdens to the bankruptcy system that their jockeying with each other entails. And, of course, their efforts to make other creditors pay the fees for that jockeying make things worse."

[6] However, after assessing both sides of the issue, Judge Gerber decided that any public policy concerns were not so clear that he was willing to override his reading of the Code.

### **B. What type of fees would meet the reasonableness test in the SDNY?**

Having found the fee provision to be permissible, Judge Gerber turned to the reasonableness standard. Judge Gerber noted that “other concerns that normally would be important to a bankruptcy court, like benefit to the estate, would not matter here.” [7] One would expect, to the contrary, that the Applicants would be looking out for no one other than themselves. He examined two types of concerns, “behavioral concerns” and “economy concerns”, to determine whether the required reasonableness standard was met when an Applicant was advancing its interest alone.

Judge Gerber refused to allow reimbursement for fees incurred to advance interests unrelated to recovering on claims or for activities that went beyond normal advocacy or negotiation and which the decision described as “outrageous”. The decision noted the highly contentious nature of the *Adelphia* litigation and expressed disbelief at certain activities engaged in by certain parties and their counsel, including, among other things: (i) Arahova Bondholders’ scorched earth litigation strategy (which the Court had previously admonished in another context); (ii) traders who shorted the Arahova bonds, (iii) parties that threatened the Debtors’ Board that its members’ failure to propose a plan to such parties’ liking would be a breach of their fiduciary duties; and (iv) parties that planted documents and information in the Wall Street Journal and other publications to advance their own goals and manipulate ongoing trading in the Debtors’ bonds. [8] Judge Gerber referred to these as behavioral concerns. In addition, Judge Gerber raised traditional bankruptcy court concerns, such as overworking a matter or running up excessive disbursements, which he referred to as economy concerns. To address the behavioral concerns, the Court required each applicant to file a declaration stating that it had not engaged in any activities giving rise to a behavioral concern or that the applicant had pruned from its application any request for compensation for such activities. The Court stated that the economy concerns had been addressed through the usual dialogue between the applicants and the U.S. Trustee. [9]

In conclusion, the Court found that a debtor could agree, in the context of a plan, with individual unsecured creditors to pay their fees without a finding of a substantial contribution by such creditors. However, the Court gave the reasonableness standard teeth by prohibiting compensation for services extended in connection with activities (a) unrelated to maximizing recovery on claims, (b) that go beyond normal advocacy or negotiation, or (c) that otherwise are abusive, irresponsible or destructive to the estate. In light of the active nature of *ad hoc* committees and other distressed debt investors in negotiating plans of reorganization, this decision

creates a meaningful opportunity for such creditors to receive payment of their fees.

1. 2010 WL 4791795 (Bankr. S.D.N.Y. Nov. 18, 2010).

2. *In re Granite Partners, L.P.*, 213 B.R. 440, 446 (Bankr. S.D.N.Y. 1997).

3. Section 1129(a) provides, in relevant part, that:

(a) The court shall confirm a plan only if all the following requirements are met:

...

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, 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...

4. 11 U.S.C. § 1123(b)(6) (emphasis added)

5. *In re Adelphia Communications Corp.*, 2010 WL 4791795, at \*15-16.

6. *Id.* at \*21.

7. *Id.* at \*23.

8. *Id.* at \*25-26.

9. *Id.* at \*29.

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