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Creditors Entitled to 'Reasonable' Fees Incurred Pursuing Self Interest

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On Nov. 18, in *In re Adelpia Communications Corp.*, the U.S. Bankruptcy Court for the Southern District of New York addressed the question of whether ad hoc committees and individual creditors of a debtor are entitled to reimbursement of their legal fees and other professional expenses where the debtor's confirmed and effective Chapter 11 plan of reorganization authorized payment of creditors' "reasonable" fees and expenses.

According to the opinion, 14 ad hoc committees and individual creditors collectively sought more than \$88 million in reimbursement of their legal fees and expenses pursuant to a provision of the plan. The trustee objected to the application for reimbursement, arguing that the creditors had not made a "substantial contribution" to the estate that would entitle them to reimbursement of their legal fees. The court held (1) that reasonable fees may be paid to creditors when the Chapter 11 plan so provides; and (2) fees are "reasonable" when expended solely to increase an applicant's personal recovery in a claim against the estate, but are not "reasonable" when expended on activities: (i) unrelated to recovering a claim; or (ii) that go beyond mere advocacy to behavior that is abusive, irresponsible or destructive to the estate.

Intercreditor Feuding

The Adelpia Communications Corp. bankruptcy has been described as one of the "most contentious in bankruptcy history," largely because of intercreditor skirmishes over incremental shares of the bankruptcy estate. In fact, the court noted that in the spring of 2005 this intercreditor feuding nearly undermined a deal to sell Adelpia's assets to Time Warner Cable for about \$19.1 billion.

According to the opinion, Adelpia initially structured its deal with Time Warner to be consummated pursuant to a plan of reorganization, rather than under Section 363 of the Bankruptcy Code, which generally permits the sale of some or substantially all of a debtor's assets outside of a plan. The Time Warner sale documents set a deadline for implementation of Adelpia's plan. As the deadline approached, the intercreditor disputes threatened to push confirmation of the plan beyond the deadline, thereby putting the entire deal at risk.

In response to this risk, Adelpia proposed restructuring the Time Warner deal as a Section 363 sale, which would allow the estate to receive the \$19.1 billion in sale proceeds before the creditors' rights to their shares of the proceeds were determined. While the restructuring of the deal as a Section 363 sale put the proceeds immediately into the estate, it did nothing to eliminate the intercreditor feuding.

In order to provide structure to the creditors' battles, the court granted Adelpia's Motion in Aid of Confirmation (MIA), which provided a framework for the resolution of the intercreditor disputes. After about three months of

litigation under the MIA, the court approved a mechanism through which Adelphia hoped to achieve a settlement with the creditors, which would allow for the confirmation of a plan. After lengthy negotiations, the parties agreed to certain revisions to the proposed plan, and the revised plan was confirmed.

As part of the confirmed plan, the estate was required to bear creditors' fees expended in the course of the MIA litigation, the intercreditor battles, the negotiations to end the fighting, and in any other aspect of the case. Section 6.2(d) of the plan stated that applicants "shall receive reimbursements of their reasonable fees and expenses incurred in connection with the Chapter 11 Cases as Administrative Claims ... [and] shall comply with any procedures required by the Bankruptcy Code in connection with seeking reimbursement," according to the opinion. As part of the confirmation order, the court acknowledged that it was skeptical about whether such fees could be paid by the estate, but said that it would "keep an open mind" about awarding any fees requested under Section 6.2(d) of the plan.

The court required that any creditor wishing to be reimbursed for its fees in connection with the bankruptcy case submit a fee application and include in the application any argument that supported its request for fees. All told, 14 ad hoc committees and individual creditors (collectively, the applicants) filed applications (the applications) for reimbursement of their fees. The court said that: "Though some [of the applicants] were more litigious and aggressive than others, most of the applicants were antagonists in the intercreditor disputes, as each tried to increase its incremental share of the pie." The creditors' committee supported the applications, but the U.S. trustee opposed the applications based largely on the court's initial skepticism set forth in the confirmation order.

Is Reimbursement Permitted, 'Reasonable'?

The court first addressed whether the Bankruptcy Code permits the type of fee reimbursement included in Adelphia's plan. Finding that this type of reimbursement provision is permitted under the code, assuming certain requirements are met, the court went on to address whether the fees were "reasonable."

- Does the code permit reimbursement of creditors' fees?

The court first addressed the plain language of the code, which expressly allows for the payment of a nonfiduciary creditor's fees if the fees were expended in making a "substantial contribution" to the estate. (See 11 U.S.C. § 503(b)(3)(D).) The court noted that while this section authorizes the payment of fees only in certain circumstances, it does not purport to be the only section under which a creditor's fees may be reimbursed. The court next looked at Section 1129 of the code, which provides, in part, that a plan shall be confirmed only if any payments made as part of the plan are approved by the bankruptcy court as "reasonable." In support of the applications, counsel for the creditors' committee argued that Section 1129(a)(4) allows the applicants to recover their reasonable fees, without the burden of establishing that their efforts made a "substantial contribution" to the estate under Section 503(b)(3)(D).

Ultimately, the court agreed that Section 1129(a)(4) allows for the inclusion of a provision in a plan that provides for the reimbursement of creditors' legal fees, so long as the provision is consistent with Section 1123(b)(6), which states that a plan may include "any other appropriate provision not inconsistent with the applicable provisions" of the code. The court easily found that the reimbursement provision was not inconsistent with the applicable provisions of the code because, as previously determined, Section 503(b)(4)(D) is not defined as the exclusive means by which a creditor may recover its legal fees.

The court next addressed whether such a provision could be considered "appropriate." Finding no guidance in the text of the code and little guidance in case law as to how to define "appropriate" in this context, the court acknowledged significant policy concerns related to the reimbursement of fees expended by creditors advancing their own private interests without benefiting the estate. Ultimately, however, the court determined that the reimbursement provision was appropriate, because it did not violate any statutory or case law.

- Were the applicants' fees "reasonable" in this case?

After the court determined that the Bankruptcy Code did not prohibit the enforcement of the reimbursement provision, the court next examined whether it would be reasonable for the estate to pay the fees of creditors whose sole goal was to increase their own individual recovery, and whose behavior was in fact detrimental to the estate. First, the court noted that self-interest alone would not give rise to a finding that the requested fees were unreasonable, because the applicants should not be expected to pursue any interests other than their own.

Second, the court addressed the behavior of the applicants in pursuing their own interests. The court noted that the behavior of some of the applicants was "outrageous" and that several of the applicants had engaged in "scorched earth litigation" tactics in an attempt to undermine Adelpia's deal with Time Warner in order to gain leverage. The court, citing its decision in a prior motion, noted that such tactics should not be rewarded through the reimbursement of fees expended in connection with such behavior. In finding this behavior not to be "reasonable," the court took a Solomon-like approach, allowing the estate to reimburse the applicants for fees that had been expended in order to maximize each applicant's recovery on its claim, but prohibiting the reimbursement of fees expended for activities that went beyond mere advocacy to behavior that was "abusive, irresponsible or destructive to the estate."

Balancing the Interests

Judge Robert E. Gerber's opinion in *In re Adelpia Communications Corp.* identifies the difficulties inherent in balancing the interests of the wide variety of constituencies involved in every bankruptcy case. Here, although the applicants' actions were oftentimes detrimental to the estate, the sale of Adelpia's assets to Time Warner could not have been accomplished without Adelpia agreeing to the reimbursement provision included in the confirmed plan.

Ultimately, if a plan includes a provision that allows for the reimbursement of creditors' fees, the provision will be enforceable, but only to the extent that the fees, and the underlying behavior of the creditors, is reasonable.

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