Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT™ SEPTEMBER 2014

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:
Kent K. B. Hanson, J.D. at ..... 1-800-424-0651 ext. 3207
Email: ..... kent.hanson@lexisnexis.com
For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3000
Fax Number . . . . . (518) 487-3584
Customer Service Web site . . . . . http://www.lexisnexis.com/custserv/
For information on other Matthew Bender publications, please call

Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)

Cite this publication as:

[author name], [*article title*], [vol. no.] Pratt's Journal of Bankruptcy Law [page number] (LexisNexis A.S. Pratt);
Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 Pratt's Journal of Bankruptcy Law 349 (LexisNexis A.S. Pratt)

An A.S. Pratt™ Publication

Editorial Offices
121 Chanlon Rd., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

MATTHEW BENDER

(2014–Pub.4789)

Editor-in-Chief & Board of Editors

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company., Inc.

POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974.

Committee Members' Professional Fees and Expenses: To Pay or Not to Pay, That Is the Question

Ingrid Bagby and Michele C. Maman*

The United States District Court for the Southern District of New York entered a decision in Davis v. Elliot Management Corp., et al. (In re Lehman Bros. Holdings Inc.) *addressing the applications for payment of professional fees in the approximate total amount of $26 million submitted by certain members of the official committee of unsecured creditors appointed under Section 1102 of the Bankruptcy Code in the historical and unprecedented bankruptcy cases of Lehman Brothers Holdings Inc. and its affiliated debtors. The authors of this article discuss the case and its implications.*

The United States District Court for the Southern District of New York entered a decision in *Davis v. Elliot Management Corp., et al. (In re Lehman Bros. Holdings Inc.)*[1] addressing the applications for payment of professional fees in the approximate total amount of $26 million submitted by certain members of the official committee of unsecured creditors (the "Committee") appointed under Section 1102 of the Bankruptcy Code—*i.e.* an official committee—in the historical and unprecedented bankruptcy cases of Lehman Brothers Holdings Inc. and its affiliated debtors (collectively, the "Debtors"). At issue before the district court was an appeal by the United States Trustee for Region 2 (the "UST") from the February 15, 2013 decision of Judge James Peck of the United States Bankruptcy Court for the Southern District of New York, pursuant to which Judge Peck granted an omnibus application (the "Application") for the payment of fees and reimbursement of expenses claimed by individual members of the Committee despite an objection by the UST. In a decision that was viewed with surprise by some, the district court disagreed with the bankruptcy court as to the permissibility of the fees and expenses, and remanded the matter back to the bankruptcy court for further adjudication. The Committee members thereafter filed a motion—albeit unsuccessful—seeking immediate certification for interlocutory appeal of the district court's order to the United States Court of Appeals for the Second Circuit pursuant to 28 U.S.C. § 1292(b) with respect to the district court's reversal of the bankruptcy court's decision insofar as it awarded the fees as permissible consensual plan payments.

Specifically, as acknowledged by the bankruptcy court, the dispute as to whether to allow the professional fees of Committee members highlights the potential ability to use Chapter 11 plan provisions as a means to authorize and effectuate the payment of professional fees in instances where such fees would otherwise likely not qualify as

---

* Ingrid Bagby is a partner at Cadwalader, Wickersham & Taft LLP, focusing her practice on bankruptcy, restructuring, and commercial litigation. Michele C. Maman is an associate at the firm. The authors may be contacted at ingrid.bagby@cwt.com and michele.maman@cwt.com, respectively.

[1] *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, 508 B.R. 283 (S.D.N.Y. 2014).

recoverable administrative expenses under Sections 503(b)(3) and 503(b)(4) of the Bankruptcy Code.[2]

BANKRUPTCY COURT DECISION

Section 503(b)(3) of the Bankruptcy Code sets forth those fees that, after notice and a hearing, shall be allowed as administrative expenses. In particular, Section 503(b)(3)(F) includes the fees of "a member of a committee appointed under section 1102 [of the Bankruptcy Code], if such expenses are incurred in the performance of the duties of such committee."[3] Meanwhile, Section 503(b)(4) authorizes the "reasonable compensation for professional services rendered by an attorney. . ..of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney. . .."[4] Notably, subparagraph (F) of Section 503(b)(3) is not mentioned in the list of subsections enumerated in Section 503(b)(4). Accordingly, as the Lehman bankruptcy court explained, when read collectively, these provisions seemingly authorize official committee members to seek reimbursement for expenses incurred in connection with their service on the committee, but *not* for professional services rendered to individual committee members.[5]

Based on the foregoing statutory analysis, the Lehman bankruptcy court concluded that the fees sought by the Committee members in the Application did not qualify for payment in the ordinary course as administrative expenses under Sections 503(b)(3) and 503(b)(4). However, by what was presumably intentional draftsmanship in attempt to circumvent the very issues that are now in play before the courts, Section 6.7 of the Debtors' Chapter 11 plan (the "Plan") expressly secured the right to payments of such fees for the Committee members, notwithstanding the absence of any statutory basis therefore. Indeed, Section 6.7 of the Plan "introduce[d] what amount[ed] to a contractual patch designed to cure these statutory omissions, and therein lies the rub." Given the fact that the requested fees were not explicitly authorized under the Bankruptcy Code, but nevertheless were authorized under the Plan, the question before the bankruptcy court put at stake "important appearance and policy issues: should members of any official committee who by statute have a central role in plan negotiations be allowed to use the plan process for their own financial gain and should they be able to realize benefits that the Bankruptcy Code ordinarily would not sanction?" Notably, while payment of such fees may not be expressly referenced within the Bankruptcy Code itself, the Bankruptcy Code nonetheless considered the purported banality of using a Chapter 11 plan to achieve

---

[2] *In re Lehman Bros. Holdings Inc.*, 487 B.R. 181, 183–184 (Bankr. S.D.N.Y. 2013).

[3] 11 U.S.C. § 503(b)(3)(F).

[4] 11 U.S.C. § 503(b)(4).

[5] *In re Lehman Bros. Holdings Inc.*, 487 B.R. 189-190 (Bankr. S.D.N.Y. 2013).

permissible "desired economic outcomes" and to reflect consensual arrangements between debtors and their stakeholders.

The UST's objection to the Committee members' Application advanced what the bankruptcy court ultimately described as an "overly restrictive reading of section 503(b)" and was premised on the presumption that Section 503(b) was the "exclusive pathway" by which the Committee members could potentially be entitled to receive compensation. In other words, the UST's reading of the Bankruptcy Code argued that Section 503(b) not only eliminates the potential for members of an official committee to recover fees thereunder, but also forecloses any ability for such amounts to be recovered by other permissible means within the Chapter 11 context-such as under the Plan. In contrast, the Committee members argued that Section 503(b) is not the *only* mechanism for approval of administrative expenses for professional fees and expenses, and that courts may also properly look to other potentially applicable provisions of the Bankruptcy Code-namely Section 1129(a)(4)-which permits a bankruptcy court to approve a restructuring plan if payments made for services or costs and expenses in connection with the case or plan are found to be reasonable.

Ultimately, the bankruptcy court was persuaded by the Committee members' arguments and ruled that, if upheld, the UST's argument "would negate in absolute terms the possibility of plan treatment that might offer to compensate members of an official committee for their individual professional fees under any and all circumstances." Notably, the bankruptcy court categorized the UST's argument as flawed in that it presumed that Section 504(b) "functions as a trump card that extends across the Bankruptcy Code to block the formulation of a plan that proposes independent grounds for granting comparable payment rights." Further, the bankruptcy court highlighted that the UST's argument failed to consider not only the broad leeway that debtors have pursuant to Section 1123(b)(6) of the Bankruptcy Code, but also the discretion and authority afforded to bankruptcy courts under Section 1129(a)(4) to approve reasonable payments.[6] Indeed, as the bankruptcy court stated, "[t]o fulfill its reorganization purposes, a plan must be an endlessly adaptable tool that fits the particular needs and dynamics of each case. The free expression of plan proponents should not be restrained except to the extent of complying with the requirements of the Bankruptcy Code that govern plan content."

DISTRICT COURT DECISION

Although persuasive to the bankruptcy court, the arguments of the Committee members in pursuit of their Application were not as well-received on appeal to the district court. Rather, in its decision dated March 31, 2013, the district court vacated the bankruptcy court's decision and remanded to the bankruptcy court for a determination as to whether the Committee members' professional fee expenses

---

[6] Further, the bankruptcy court noted its "general repository of power" under Section 105(a) of the Bankruptcy Code to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." *In re Lehman Bros. Holdings Inc.*, 487 B.R. 190 (Bankr. S.D.N.Y. 2013) (quoting 11 U.S.C. § 105(a)).

qualified for payment under Sections 503(b)(3)(D) and 503(b)(4) of the Bankruptcy Code.[7] While, as noted above, the bankruptcy court did not deem Section 6.7 of the Plan to be inconsistent in any respect with the Bankruptcy Code and, thus, permissible under Section 1123(b)(6), the district court was more persuaded by the UST's argument that Section 503(b) expressly prohibited the payment of the Committee members' professional fee expenses and, consequently, that such payments could not be authorized under Section 1123(b)(6).

In so holding, the district court stated that "[t]he problem is not that such expenses are not listed [in Section 503(b)]- the list is not exhaustive—but instead that the structure of § 503(b)(3) and (4) glaringly exclude professional fee expenses for official committee members." Indeed per the district court, Section 503(b)(3) allows for the payment of "actual, necessary expenses" associated with those situations expressly listed in Sections 503(b)(3)(A) through (F), but explicitly excludes professional fee expenses as authorized expenses, which are instead governed under Section 503(b)(4). Meanwhile, Section 503(b)(4) permits professional fee expenses for those entities that qualify for expenses under Sections 503(b)(3)(A) through (E). On its face, an official committee-governed by Section 503(b)(3)(F)-is excluded from such list. "Consequently, § 503(b)(3) and 503(b)(4) work together to guarantee full payment for any professional fee expense incurred in a situation covered by § 503(b)(3)(A) through (E), but not (F)." The district court's interpretation of the statutory history of these provisions also confirmed its view. The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act specifically amended Section 503(b)(4) to exclude professional fee expenses for official committee members.[8]

The district court was similarly not persuaded by the Committee members' arguments that Section 6.7 of the Plan does not provide them administrative expenses, but instead authorizes permissive "plan payments." The district court reasoned, however, that if a restructuring plan could authorize such "plan payments" by merely labeling them as such instead of as "administrative expenses," notwithstanding the provisions of the Bankruptcy Code, then it is conceivable that a plan could also provide for payments that circumvent the hierarchy of the Bankruptcy Code, for instance.[9] Interestingly, in *In re Adelphia Communications Corp.*, the court upheld the payment of permissive plan payments outside of Section 503(b).[10] The district court, however, was ultimately not persuaded by the reasoning in *In re Adelphia* or by the arguments of the Committee members relying on such case.[11]

Notwithstanding the foregoing, and fortunately for the Committee members, the

---

[7] *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, 508 B.R. 283 (S.D.N.Y. 2014).

[8] Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. 109–8, 119 Stat. 23 (2005).

[9] *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, 508 B.R. 283, 293 (S.D.N.Y. 2014).

[10] *In re Adelphia Communs. Corp.*, 441 B.R. 6, 19 (Bankr. S.D.N.Y. 2010).

[11] *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, 508 B.R. 283, 293 (S.D.N.Y. 2014).

prospect of them recovering their fees is not over. While not addressed originally by the bankruptcy court, in their Application, the Committee members had indeed made the alternative argument that they were also entitled to payment because they had made a "substantial contribution" to the success of these unprecedented and Chapter 11 cases overall. Ultimately, the district court remanded the case to the bankruptcy court to address whether the Committee members had indeed made a "substantial contribution" to the case so as to warrant payment of their fees under Sections 503(b)(3)(D) and 503(b)(4). Although the district court held that Section 503(b) "does not authorize payment of professional fee expenses solely on the basis of official committee membership," it recognized that such structure simply creates a per se rule that official committee members should not have their professional fee expenses paid. However, the district court further noted that "there is no reason to think that the Bankruptcy Code would punish an entity that *has* made a substantial contribution solely because it was also willing and able to serve on the official committee." This protection should not be withheld from parties simply because they were elected to serve on an official committee-indeed, "[n]othing in the language of the statute requires or suggests such a perverse outcome." In numerous instances the bankruptcy court's decision acknowledged the negotiation process that ensued in connection with devising the Plan, describing it as "unprecedented in its complexity and involv[ing] exceptionally difficult questions."[12] It now remains to be seen whether the unpredictability and overwhelmingly complex issues that the Committee members helped to navigate in these Chapter 11 cases will be deemed sufficient to satisfy the "substantial contribution" requirements so as to justify payment to the Committee members under Sections 503(b)(3)(D) and 503(b)(4) of the Bankruptcy Code.

APPEAL TO THE SECOND CIRCUIT

On April 25, 2014, the Committee members filed a motion seeking immediate certification for interlocutory appeal of the district court's March 31, 2014 order to the United States Court of Appeals for the Second Circuit pursuant to 28 U.S.C. § 1292(b) with respect to the district court's reversal of the bankruptcy court's decision insofar as it awarded the fees as permissible consensual "plan payments" under Sections 1123(b)(6) and 1129(a)(4) of the Bankruptcy Code.[13] The Committee members have argued that case law supports certification of the plan payment question to the Second Circuit staying any further litigation with respect to the order in the bankruptcy court during the pendency of the appeal. They argue that resolution of this question in their favor would obviate any need for a "substantial contribution" determination, and save all the time, efforts, and funds required to make such a determination. Further, they allege that any resolution of the plan

---

[12] *In re Lehman Bros. Holdings Inc.*, 487 B.R. 187 (Bankr. S.D.N.Y. 2013).

[13] Motion of Appellees Requesting Certification of March 31, 2014 Order for Interlocutory Appeal and Issuance of a Stay Pending Appeal, *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, No. 13 Civ. 2211 (RJS) (S.D.N.Y. Apr. 25, 2014).

payment question would potentially narrow the issues ultimately appealable to the Second Circuit. On the other hand, "addressing the matters remanded for further findings in the Bankruptcy Court before the appeal is resolved could only result in the duplicative and unnecessary consumption of litigant and judicial resources, for the dubious purpose of adjudicating issues that may never need to be litigated." In other words, it appears that the "substantial contribution" issue may never need to be litigated if the plan payment issue is decided in the Committee members' favor. Oral argument on the motion seeking immediate certification for interlocutory appeal went forward before Judge Richard J. Sullivan on May 30, 2014. At the time, the district court reserved decision. Ultimately, however, on June 30, 2014, the district court denied the Committee members' motion for a certificate of appealability pursuant to 28 U.S.C. § 1292(b).[14]

Specifically, the district court found that two of the three requirements for a district court to certify an immediate appeal of an interlocutory order were not satisfied. Indeed, a district court may certify an immediate appeal of an interlocutory order if the court finds that

(1) the order "involves a controlling question of law;"

(2) "as to which there is substantial ground for difference of opinion;" and

(3) "that an immediate appeal from the order may materially advance the ultimate termination of the litigation."[15]

Here, while there was no dispute amongst the parties that a controlling question of law was at issue, the district court did not find that there was a substantial ground for difference of opinion, or that an immediate appeal would materially advance the litigation.

First, as to the "substantial ground for difference of opinion" prong, the district court noted that it "believes its decision was correct" but that, more importantly, it did not find any "substantial doubt" that the decision was correct.[16] If "debtors and creditors could freely fashion 'plan payments' whenever it might help the bankruptcy process, one would expect such payments to be common." And yet, "throughout the entire history of the Bankruptcy Code," the Committee members have only cited to three decisions that have authorized the types of plan payments they seek. All of those decisions are from the last four years and from the Southern District of New York Bankruptcy Court—and only one of such decisions (*In re Adelphia*) even contained any analysis on the issue. Therefore, the fact that there exists several bankruptcy court opinions based on reasoning that the district court already determined to be unpersuasive here does not, per the court, create a "substantial doubt" that its opinion was correct.

---

[14] *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, No. 13 Civ. 2211 (RJS) (S.D.N.Y. June 30, 2014).

[15] 28 U.S.C. § 1292(b).

[16] *Davis v. Elliot Mgmt. Corp. (In re Lehman Bros. Holdings Inc.)*, No. 13 Civ. 2211 (RJS), at 3 (S.D.N.Y. June 30, 2014).

Next, as to the prong requiring that an immediate appeal materially advance termination of the litigation, the district court noted that if the Committee members are unsuccessful on appeal-the more likely scenario in the district court's opinion-the same proceedings in the bankruptcy court that the Committee members are facing now would be required and, further, there would also be a second round of appeals to seek review of the bankruptcy court's application of Section 503(b)(3)(D). While in some cases there are indeed benefits of accepting the risk of piecemeal appellate review, the district court found that the remaining issue in the instant case-the bankruptcy court's application of Sections 503(b)(3)(D) and 503(b)(4)-is a single, discrete issue that the Committee members have already addressed, and also one that the bankruptcy court has ample experience deciding. Therefore, the district court held that "granting an interlocutory appeal is likely to waste time instead of save time."

Lastly, the district court noted that the instant case is not an "exceptional" case that would justify an interlocutory appeal. There has not been any assertion by the Committee members that waiting for a final order would cause them any prejudice beyond delay and added litigation expense. Further, as previously noted, the proceedings that remain before the bankruptcy court require adjudication of a single discrete issue and, thus, there is not a question of prolonged pretrial and trial efforts at stake here. Moreover, any possibility of uncertainty that may transpire as a result of the district court's decision was found by the district court to be relatively limited and, regardless, nothing that would rise to the level of being "exceptional" so as to justify an interlocutory appeal.

Based on the foregoing opinion of the district court, it thus appears that the "substantial contribution" question will likely ultimately go forward. In the interim, committee members generally will need to consider their expectations for reimbursement of individual counsel legal fees, given the Lehman district court's decision and the potential for conflict with the prior decision in *Adelphia*. Thus, until there is clarity on these issues, committee members in the future may be restricted to seeking reimbursement only on a "substantial contribution" basis.