

ALERTS

Losing Acquiror in Competing Reorganization Plan Fight Has Standing to Seek Reimbursement of Fees and Expenses

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A New York bankruptcy court recently held that a losing acquiror in a competing Chapter 11 plan fight had “standing” to seek reimbursement of its legal fees and expenses as a “substantial contribution” to the reorganization case. *In re S & Y Enterprises, LLC, et al.*, 2012 Bankr. LEXIS 4622, at *4-*5 (Bankr. E.D.N.Y., September 28, 2012). Nevertheless, the losing acquiror failed to recover because, in the court’s view, it did not satisfy the statutory requirements for reimbursement with the requisite “preponderance of the evidence.” *Id.* According to the court, Bankruptcy Code (“Code”) § 503(b)(3)(D) permits an entity in a reorganization case “to seek . . . to recover its ‘actual, necessary expenses’ in making a substantial contribution” only if it proves that its “contributions are of such consequence to the bankruptcy process and the parties as a whole that the debtor’s estate, rather than the entity should bear the reasonable cause of those contributions . . .” *Id.*, at *2. The losing acquiror failed this test, reasoned the court, in an arguably close call.

Relevance

S&Y deals with an asset acquiror who had no contractual expense reimbursement rights. On the facts stated by the court, the acquiror never asked for such a provision when making its offer to the debtors. More significant, however, was the court’s giving the acquiror standing to

seek reimbursement while imposing, at the same time, a virtually impossible obstacle to recovery.

Facts

Each of the two debtors in *S&Y* was a single asset real estate entity with properties in New York City. They had initially agreed to sell their properties to acquiror A for \$20 million plus a 25 percent interest in the acquiring entity. A intended to develop the properties “into an upscale retail property.” *Id.*, at *6. Because of “increased construction costs and zoning issues,” A later reduced the purchase price “from \$20 million to \$16.5 million.” *Id.*, at *6. When a lender and another entity objected to the debtors’ proposed reorganization plan based on the proposed asset sale to A, a new potential acquiror, B, offered to buy the property for \$21 million, plus a 35 percent equity interest. After further litigation, A increased its offer to \$21.9 million, with a waiver of its claims based on the debtors’ rejection of the original sale agreement. Despite B’s objection, the court eventually confirmed a new reorganization plan based on A’s higher bid.

B later applied to the court, seeking “allowance of an administrative expense for making a substantial contribution in” the two debtor cases. According to B’s papers, “it contributed to the success of the . . . reorganization by causing [A], the successful purchaser, to increase its offer for the Debtors’ properties, by drafting and defending the Debtors’ . . . plans and disclosure statements, which were ultimately not confirmed, by participating in motion practice and negotiations, and by paying the counsel fees and expenses of the Debtors’ principals . . .” *Id.*, at *3.

Standing to Seek Substantial Contribution Award

Code § 503(b)(3)(D) enables certain prospective applicants, “including . . . a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders” to seek a substantial contribution award. Because this list is nonexclusive, lower courts are split as to whether standing is limited to creditors. The *S&Y* court found the list of prospective applicants in Code § 503(b) to be “illustrative, not exclusive.” 2012 Bankr. LEXIS 4622, at *17-18. The court explained that, “a substantial contribution in a chapter 11 case may come from many quarters, and that sometimes, an applicant’s efforts in advancing a debtor’s reorganization are of such a nature and extent that the

reasonable costs of those efforts should be shifted from the applicant to the estate. . . . But § 503 does not open that door too wide, and the inquiry in each situation should be case-specific and fact-intensive.” *Id.*, at *18.

Losing Acquiror Has Standing

Rejecting arguments as to B’s lack of standing, the court held that B had standing to apply for a “substantial contribution” award “to recover the counsel fees and expenses that it paid on behalf of itself and [the debtors’ principals],” reasoning that the Code’s list of “prospective applicants” is an “illustrative, not an exclusive, list.” *Id.*, at *20.

Standard for Substantial Contribution Award

The applicant for a substantial contribution award has the burden of proving by “a preponderance of the evidence” that it is entitled to extraordinary relief. *In re Drexel Burnham Lambert Grp. Inc.*, 134 B.R. 482, 489 (Bankr. S.D.N.Y. 1991). The burden “is exceedingly difficult since the general presumption is that the [applicant] is acting in its own interest.” *In re Villa Luisa*, 354 B.R. 345, 348 (Bankr. S.D.N.Y. 2006).

B’s Arguments

B argued that its efforts resulted in a \$4.5 million higher bid from A; “provided a greater ownership interest in” the reorganized entity for the debtors’ principals; enhanced the debtors’ “negotiating leverage” with A; formulated and defended a new reorganization plan on the debtors’ behalf; participated in “extensive discovery” to show that it “was a ‘real’ bidder and that the second amended plans were viable”; and participated in motion practice and discovery. 2012 Bankr. LEXIS 4622, at *28. Arguing that “it effectively acted as co-counsel to the Debtors,” that its services were “essential” and that “self-interest [did] not preclude” an award, B sought “counsel fees and expenses” of “more than \$1 million.” *Id.*, at *28-29.

Court’s Reasoning: Indirect Benefit Not a Substantial Contribution

Despite granting B standing to seek reimbursement, the court denied its application. First, B's activities were "principally in furtherance of its efforts to acquire the Debtors' properties . . . and to advance [its] own interests, not the interests of the bankruptcy estate or the parties as a whole." *Id.*, at *32. Second, despite causing A to increase its purchase price, the court found this activity led to "an indirect benefit" which was "not enough." *Id.*, at *32-*33. Finally, although the reorganization was successful in the sale of the debtors' properties, B's "efforts were directed towards its own objectives, not the entire bankruptcy process." *Id.*, at *33.

Comments

1. The *S&Y* court summarily dismissed the tangible benefit conferred by B on the debtors' estate and all creditors: causing A to increase "its offer for the . . . properties by \$4.5 million. . . ." *Id.*, at *28. According to the court, "the primary objective of [B's] activities was to advance [its own] interest, not the interest of the bankruptcy estate or the parties as a whole." *Id.*, at *32. As shown below, however, the court's analysis is unfairly narrow in view of applicable case law.

2. B was no mere bidder at an auction. When A, the only apparent buyer, unilaterally reduced its original bid, B stepped up with a \$4.5 million higher bid, causing A to top B's offer by another \$900,000. B also did the work to amend the debtors' original reorganization plan and disclosure statement, effectively inducing A to return with an even higher offer for the debtors' assets. In the end, it was only because of B's effort that creditors realized \$21.9 million rather than the reduced \$16.5 million offer from A.

3. Significantly missing from the *S&Y* court's decision was any mention of important appellate decisions authorizing "substantial contribution" awards on similar or even less favorable facts. *See, e.g., In re DP Partners Ltd. Partnership*, 106 F.3d 667, 673 (5th Cir. 1997) ("Thus, the phrase 'substantial contribution . . . means a contribution that is 'considerable in amount, value or worth.' The benefits, if any, conferred upon an estate are not diminished by selfish or shrewd motivations. We therefore hold that a creditor's motive in taking actions that benefit the estate has little relevance in the determination whether the creditor has incurred actual and necessary expenses in making a substantial contribution to a case. . . . At a minimum, the court should weigh the cost of the claimed fees and expenses against the benefits conferred upon the estate which flow directly from those actions"; party discovered fraudulent transfers, and

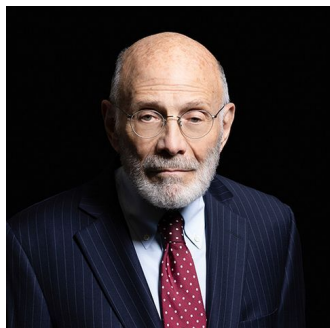
caused amendment of reorganization plan; “. . . participation in the confirmation fight resulted in a least a \$3,000,000 benefit to all creditors of the estate.”).

Authored by Michael L. Cook.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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