AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Feature

By Jeffrey Chubak[1]

Nixing Permissive Plan Payments Effectively Repeals § 1129(a)(4)

Editor's Note: *For more on the effects of the* Lehman *bankruptcy, see the articles on pages 14 and 16 of this issue.*

Jeffrey Chubak
Proskauer; New York

Jeffrey Chubak is an associate in Proskauer's Business Solutions, Governance, Restructuring, and Bankruptcy Group in New York.

In a recent decision, Hon. Richard J. Sullivan vacated Hon. **James M. Peck**'s memorandum decision approving the payment, pursuant to the Lehman Brothers chapter 11 plan, of the reasonable professional fees of members of the statutory committee of unsecured creditors in the *Lehman* case.[2] Judge Sullivan's decision should raise eyebrows for two reasons. First, although the decision was limited to a dispute over "permissive plan payments" to statutory committee members, it raises significant questions concerning the continued viability of the widely accepted practice of paying the professional fees of *other* creditors under a plan (*e.g.*, indenture trustees, administrative agents and ad hoc groups) without a prior court determination that such creditors made a substantial contribution to the case. Second, although it purports not to, the decision effectively renders § 1129(a)(4) of the Bankruptcy Code surplusage.

Background

The Lehman Brothers plan included a provision providing that the reasonable professional fees incurred by statutory committee members and indenture trustees prior to the plan's effective date would be allowed as administrative expenses, and paid by the debtors upon application to the court and subject to court approval.[3] Following plan confirmation, the statutory committee members and indenture trustees filed an application seeking payment of their respective professional fees in the aggregate amount of approximately $26 million, to which the U.S. Trustee objected on the grounds that such fees did not qualify as administrative expenses under § 503(b) of the Bankruptcy Code.[4]

In a memorandum decision, the bankruptcy court granted the application, holding that § 503(b) does not prohibit payment of the fees in question pursuant to a plan and that the relevant plan provision is permitted under § 1123(b)(6) of the Bankruptcy Code, provided that the payments thereunder are subject to court approval as reasonable in accordance with § 1129(a)(4).[5] The court further relied on Hon. **Robert E. Gerber**'s *Adelphia* decision authorizing the payment, pursuant to a chapter 11 plan, of the professional fees of 14 ad hoc groups and certain individual creditors over the U.S. Trustee's objection.[6]

Several months later, the permissibility of paying statutory committee members' professional fees pursuant to a chapter 11 plan was litigated in American Airlines' chapter 11 cases, with the U.S. Trustee again opposing such payments. In a memorandum decision, Hon. Sean H. Lane approved the payments in question, following the reasoning of *Adelphia* and *Lehman Brothers*.[7]

The District Court's Decision

On appeal, the district court nixed the payment of statutory committee members' professional fees pursuant to the Lehman Brothers plan. At the out-

1 The views expressed herein are solely those of the author.
2 *See In re Lehman Bros. Holdings Inc.*, 508 B.R. 283 (S.D.N.Y. 2014).
3 *In re Lehman Bros. Holdings Inc.*, 487 B.R. 181, 187 (Bankr. S.D.N.Y. 2013).
4 *Id.* at 188.
5 *Id.* at 190-91. Section 1123(b)(6) provides that a plan may include any "appropriate" provision that is "not inconsistent with" the Bankruptcy Code. Section 1129(a)(4) provides that a plan may only be confirmed if "[a]ny 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."
6 *Lehman Bros.*, 487 B.R. at 191-93 (quoting *In re Adelphia Commc'ns Corp.*, 441 B.R. 6, 13-15, 19 (Bankr. S.D.N.Y. 2010)).
7 *In re AMR Corp.*, 497 B.R. 690, 694-96 (Bankr. S.D.N.Y. 2013).

set, the court held that § 503(b) is the exclusive "avenue" for paying allowed administrative expenses, and that neither § 503(b) nor its "interstices" (*i.e.*, other Code sections affording certain payments administrative-expense status) permit the payment of statutory committee members' professional fees as allowed administrative expenses.[8]

The court also held that the plan provision providing for the payment of statutory committee members' professional fees could not be justified as a "permissive plan payment" authorized by § 1123(b)(6) for two reasons. First, chapter 11 plans may only provide for the payment of allowed "administrative expenses" and "claims."[9] However, statutory committee members' professional fees do not fall within the scope of § 503(b), as noted above, and statutory committee members' professional fees do not qualify as "claims" under the Bankruptcy Code.[10] Second, authorizing the payment of such fees could result in debtors circumventing the Code's requirements, *i.e.*, § 503(b), which the Second Circuit prohibited in the context of non-consensual "gifting" chapter 11 plans in *DBSD*.[11] In a footnote, the court rejected the statutory committee members' argument that § 1129(a)(4) justified the payments at issue, stating that the section served an entirely different purpose:

> Section 1129(a)(4) is partly focused on ensuring disclosure of payments made in connection with the plan, but not written into the plan.… That section therefore necessarily addresses payments other than those governed by § 503(b), which would all be addressed in the plan itself. However, § 1129(a)(4)'s contemplation of payments outside of the plan in no way implies the possibility of freestanding non-claim and non-expense payments *under* the plan.[12]

The court remanded for consideration the statutory committee members' alternative argument that their professional fees should be paid as allowed administrative expenses pursuant to § 503(b)(3)(D) and (b)(4) for having made a substantial contribution in the *Lehman Brothers* cases.[13]

The Decision's Implications

While the district court's decision was limited to the issue of the payment of statutory committee members' professional fees, the decision raises significant questions concerning the ability to pay other creditors' professional fees without a prior court determination that those such creditors made a substantial contribution to the case. Somewhat common plan provisions providing for the payment of indenture trustees' and administrative agents' reasonable professional fees have been justified on the grounds that such parties have a contractual charging lien and a right to priority in payment over bondholders and lenders.

Similar payments to ad hoc groups pursuant to a plan have likewise been justified on the grounds that such groups play a key role in formulating a plan that is acceptable to the creditor body. The decision suggests that such payments might be unacceptable unless the creditors independently qualify for an allowed administrative expense (*i.e.*, are granted a substantial contribution claim). However, the standard for demonstrating a substantial contribution is difficult to satisfy, and a substantial contribution application may be challenged even when a debtor and its creditor constituency support the same.[14]

It is difficult to believe that more than 30 years after *Northern Pipeline* and the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 that the Supreme Court would today hold that bankruptcy courts may hear and determine such proceedings, notwithstanding § 1129(a)(4)'s plain language.

The Decision Effectively Renders § 1129(a)(4) Surplusage

Given the decision's implications, it is disappointing that the district court relegated to a footnote § 1129(a)(4)'s relevance to the debate over whether the Bankruptcy Code permits the payments at issue. The court held that even though § 1129(a)(4) does not authorize permissive plan payments, and the regulation of professional fees payable from the estate pursuant to such section is duplicative of other Code sections requiring that such fees be reasonable (*e.g.*, §§ 330(a) and 503(b)(4)), the section still serves a useful purpose insofar as it mandates disclosure and regulation of payments "made or to be made by the [plan] proponent … or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses or in connection with the case, or in connection with the plan."[15] In support of this conclusion, the decision cited several decisions and secondary sources stating that the section's plain language mandates judicial scrutiny of professional fees not payable from the estate, such as professional fees payable by a plan proponent that is not a debtor or statutory committee.[16] While § 1129(a)(4) may not specifically authorize permissive plan payments, brushing the section aside on the grounds that it exists to regulate professional fees that are not payable from the estate presents its own problem: The decision effectively renders § 1129(a)(4) surplusage because bankruptcy courts do not have subject-matter jurisdiction to regulate such fees.

Under 28 U.S.C. § 1334(a)-(b), bankruptcy courts' subject-matter jurisdiction is limited to (1) "cases under title 11" (*i.e.*, the bankruptcy petition itself),[17] (2) proceedings "aris-

8 *Lehman Bros.*, 508 B.R. at 289-91.
9 *Id.* at 293 (citing *In re Ames Dep't Stores Inc.*, 582 F.3d 422, 428-29 (2d Cir. 2009)).
10 This would not hold true to the extent that statutory committee members have a contractual right to payment of their professional fees. *See, e.g., Ogle v. Fidelity & Deposit Co. of Maryland*, 586 F.3d 143, 146-47 (2d Cir. 2009).
11 *Lehman Bros.*, 508 B.R. at 293 (citing *In re DBSD N. Am. Inc.*, 634 F.3d 79, 97-101 (2d Cir. 2011)).
12 *Id.* at 294 n.9 (citations omitted).
13 *Id.* at 295-96. Section 503(b)(3)(D) provides that allowed administrative expenses include actual, necessary expenses, other than professional fees, incurred by, among others, a creditor and indenture trustee in making a substantial contribution in a chapter 11 case. Section 503(b)(3)(F) provides that allowed administrative expenses include reasonable professional fees incurred by an entity with an allowed administrative expense under, among other sections, § 503(b)(3)(D).
14 *See, e.g., In re Granite Partners*, 213 B.R. 440, 445-46 (Bankr. S.D.N.Y. 1997).
15 *Lehman Bros.*, 508 B.R. at 294 n.9 (citations omitted). The quoted language in the text is from § 1129(a)(4).
16 *Id.*
17 *See, e.g., Stoe v. Flaherty*, 436 F.3d 209, 216 (3d Cir. 2006).

ing under title 11" (*i.e.*, proceedings relating to substantive rights created by the Bankruptcy Code),[18] (3) proceedings "arising in … cases under title 11" (*i.e.*, proceedings that would not exist outside of a bankruptcy case)[19] and (4) proceedings "related to cases under title 11" (*i.e.*, proceedings that could have a conceivable effect on the estate).[20] Pursuant to 28 U.S.C. § 157(b)(1), bankruptcy courts may hear and determine "core" proceedings (*i.e.*, (a)-(c)). However, pursuant to 28 U.S.C. § 157(c)(1), bankruptcy courts may only hear, but not determine, noncore "related-to" proceedings. In such proceedings, a bankruptcy judge must submit proposed findings of fact and conclusions of law to the district court, which are then reviewed *de novo* if a party objects to such findings or conclusions.

Professional fees not payable from the estate would clearly have no effect on the estate; therefore, a bankruptcy court would not have "related-to" jurisdiction to hear a proceeding concerning the same. Holding that the bankruptcy court nevertheless has core jurisdiction over such a proceeding by operation of § 1129(a)(4) would contradict the line of cases holding that proceedings unrelated to a bankruptcy case cannot be core. For example, in *Central Ice Cream Co.*, the U.S. District Court for the Northern District of Illinois held:

> It is apparent that the core and noncore concepts embodied in the 1984 Act envision that noncore related proceedings are to some extent removed from core proceedings, the latter being the heart of the bankruptcy matter. The terms themselves, as well as the fact that bankruptcy judges may enter final orders only in core proceedings, make this self-evident.… Accordingly, a proceeding that is not a related proceeding *a fortiori* cannot be a core proceeding.[21]

The confusion is not inexplicable. The decisions cited in support of the proposition that bankruptcy courts may, pursuant to § 1129(a)(4), regulate professional fees that are not payable from the estate largely rely on the U.S. Supreme Court's 1949 decision in *Leiman v. Guttman*, which interpreted § 1129(a)(4)'s very similar predecessor statute, § 221(4) of the Bankruptcy Act.[22]

In *Leiman*, a majority of the Supreme Court, interpreting § 221(4), held that the bankruptcy court had exclusive jurisdiction to regulate an ad hoc group's professional fees that were not payable from the estate.[23] The dissent held that such fees do not fall within the scope of the bankruptcy court's subject-matter jurisdiction.[24] The *Leiman* majority opinion was subsequently relied on by the decisions cited by the district court.[25] However, none of these decisions or the decisions cited therein analyze whether bankruptcy courts have constitutional authority to hear and determine proceedings concerning the reasonableness of professional fees not payable from the estate.

It is difficult to believe that more than 30 years after *Northern Pipeline* and the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 that the Supreme Court would today hold that bankruptcy courts may hear and determine such proceedings, notwithstanding § 1129(a)(4)'s plain language. Given this, the district court's decision effectively renders § 1129(a)(4) unnecessary and duplicative of other fee-regulation provisions in the Bankruptcy Code, a result that the Supreme Court has cautioned against.[26]

Conclusion

Nearly 20 years ago, Prof. **Kenneth N. Klee** (University of California at Los Angeles, School of Law; Los Angeles) proposed clarifying § 1129(a)(4) to limit bankruptcy court regulation of professional fees that are not payable from the estate on the grounds that regulation of such fees is "inappropriate."[27] Failure to adopt this proposal has now resulted in confusion over how professional fees for indenture trustees, administrative agents and ad hoc groups may be paid in chapter 11 cases. The statutory committee members have moved for an order certifying the district court's decision for appeal pursuant to 28 U.S.C. § 1292(b) and staying further proceedings. Appellate review, if granted, will hopefully clarify § 1129(a)(4)'s purpose and whether the Bankruptcy Code authorizes permissive plan payments. abi

Reprinted with permission from the ABI Journal, Vol. XXXIII, No. 7, July 2014.

18 *Id.*

19 *See, e.g., In re A.H. Robins Co. Inc.*, 86 F.3d 364, 371 (4th Cir. 1996).

20 *See, e.g., Pacor v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984).

21 *In re Central Ice Cream Co.*, 82 B.R. 933, 936 (N.D. Ill. 1987). Many other courts have reached similar conclusions. *See, e.g., In re Touch Am. Holdings Inc.*, 401 B.R. 107, 117 n.19 (Bankr. D. Del. 2009) ("Core proceedings represent a subset of 'related-to' proceedings."); *In re Ragland*, No. 05-18142, 2006 WL 1997416, at *3 (Bankr. E.D. Pa. May 25, 2006) (quoting *In re Marcus Hook Development Park Inc.*, 943 F.2d 261, 264 (3d Cir. 1991)) ("[W]hen determining whether a bankruptcy court has the power to determine a dispute, a court need only decide whether the proceeding 'is at least 'related to' the bankruptcy.'")); *In re Foundation for New Era Philanthropy*, 201 B.R. 382, 389 (Bankr. E.D. Pa. 1996) (citations omitted) ("[N]ot only must a core proceeding be related to a bankruptcy case, but disputes [that] might otherwise fall squarely within the examples of core matters found in 28 U.S.C. § 157(b)(2) — *e.g.*, proof of claim litigation — have been found outside bankruptcy court jurisdiction — *i.e.*, to be unrelated matters — when their outcome would not affect the bankruptcy estate.").

22 *See Leiman v. Guttman*, 336 U.S. 1 (1949) (quoting former 11 U.S.C. § 621(4), which provided that "[t]he judge shall confirm a plan if satisfied that … all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge.").

23 *Id.* at 9 (citations omitted).

24 *Id.* at 14 (Jackson, J., dissenting).

25 *Lehman Bros.*, 508 B.R. at 294 n.9 (citations omitted).

26 *See, e.g., TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001)) ("It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'").

27 *See* Kenneth N. Klee, "Adjusting Chapter 11: Fine Tuning the Plan Process," 69 *Am. Bankr. L. J.* 551, 567 (1995).