You Support My Plan, I'll Pay Your Attorneys: *Adelphia's* Troubling Precedent

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A complex chapter 11 case is at a standstill, with key parties unable to agree on the terms of a plan. To break the impasse, the debtor proposes that, as part of an agreement with certain creditors to withdraw their objections, the plan will direct the estate to pay the reasonable attorneys' fees of those creditors. Based in part on this agreement, the remaining objections are resolved, and the plan is confirmed. Does the Bankruptcy Code permit this?

According to at least one court, the answer is yes. The confirmed plan in the *Adelphia Communications Corp.* case included a provision to pay the legal fees of certain creditors who had settled their plan objections; the court subsequently approved those fees without requiring the creditors' attorneys to prove that they had made a substantial contribution under section 503 of the Bankruptcy Code.[1] The court reasoned that section 503 "is [not] the *only* way" that professional fees can be paid by the estate and relied on a little-used provision of chapter 11 to support its ruling: section 1123(b)(6), a catch-all clause authorizing plans to contain "any other provision not inconsistent" with the Bankruptcy Code.[2]

The *Adelphia* decision surely resulted from a genuine desire to conclude a contentious and difficult bankruptcy case under an unusual set of factual circumstances. But the practice of paying a creditor's attorneys' fees in exchange for plan support could quietly become more widespread after *Adelphia*. In *Adelphia* itself, the court noted there was "no reported or unreported decision analyzing the legal issues in question," only "a fair number" of orders confirming plans with similar provisions.[3] As the analysis that follows shows, critical Bankruptcy Code provisions could be at risk if the *Adelphia* decision is not strictly confined to its facts.

Adelphia's Radical Revision of Section 503

Before *Adelphia*, it would have been uncontroversial to hold that the Bankruptcy Code provides just two ways for a professional to be paid from a bankruptcy estate. First, professionals who work for the estate or an official committee are paid under section 503(b)(2), which grants administrative priority to fees and expenses awarded under section 330. Second, other professionals are paid, if at all, under section 503(b)(4), which permits the court to award "reasonable compensation" to the attorneys or accountants of entities who make a substantial contribution to the bankruptcy case in specified ways.

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[1] *In re Adelphia Commc'ns Corp.*, 441 B.R. 6 (Bankr. S.D.N.Y. 2010).
[2] *Id.* at 15 (emphasis in original).
[3] *Id.* at 9 n.8.

Both provisions contain important limitations on the fees and expenses a professional may receive. Based on its incorporation of section 330, for example, section 503(b)(2) prohibits an estate professional from receiving fees for work that did not benefit the estate,[4] that was duplicative[5] or for which the court did not approve the professional's retention.[6] Similarly, section 503(b)(4) authorizes compensation for the professionals of creditors who perform certain services, such as filing an involuntary petition[7] or recovering estate property,[8] but it does not permit professionals to be paid for assisting individual official committee members in performing their duties.[9]

The significance of *Adelphia* is that it construed 503 as a non-exclusive method for compensating professionals. Thus, even if creditors' attorneys could not satisfy the requirements of section 503, they could alternatively be paid under section 1123(b)(6), which authorizes plans to include "any . . . appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code.[10] Unlike section 503, that section does not expressly require creditors or their professionals to have made a substantial contribution in order to be compensated.[11]

It is debatable, however, whether section 1123(b)(6) should be read to provide an alternative mechanism for compensating non-estate professionals. Unless those professionals have substantially contributed to the reorganization, a plan provision to compensate them with estate funds might be "inconsistent" with the limitations of section 503, which would render 1123(b)(6) inapplicable by its own terms. Moreover, an interpretation that allows 1123(b)(6) to override the carefully crafted test of section 503 might violate the long-established rule that general statutory provisions cannot be used to negate specific ones.[12] Of arguably greater concern, however, is how this rule might undermine section 503 as a whole if its analysis is extended beyond the unique facts in *Adelphia*.

The practical problem with invoking section 1123(b)(6) as an alternative to section 503 is that, in almost any conceivable case, the "appropriate" standard will be far easier to satisfy than the detailed requirements of section 503. If section 1123(b)(6) is used to authorize payment of professional fees, section 503 becomes a nullity—an administrative claim applicant need not

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[4] 11 U.S.C. § 330(a)(4)(A)(ii)(I).
[5] 11 U.S.C. § 330(a)(4)(A)(i).
[6] 11 U.S.C. § 330(a)(1); *see generally In re Albrecht*, 233 F.3d 1258 (10th Cir. 2000) (debtor's attorneys could not be compensated under section 503(b)(2) for work performed during time period when they had not been validly retained under section 327).
[7] 11 U.S.C. § 503(b)(3)(A).
[8] 11 U.S.C. § 503(b)(3)(B).
[9] 11 U.S.C. § 503(b)(3)(D), (b)(3)(E), (b)(4). Congress' decision to exclude committee membership from the list of "substantial contributions" for which professionals as well as creditors may be compensated was deliberate. 140 Cong. Rec. H10,765 (daily ed., Oct. 4, 1994).
[10] *Adelphia* at 14-15.
[11] *Id.* at 22.
[12] *Gozlon-Peretz v. United States*, 498 U.S. 395, 407 (1991) (specific provision controls over more general one).

ever subject itself to the stringent requirements of section 503 when it can seek payment through a plan under a more relaxed standard.

The *Adelphia* rule therefore creates two entirely different standards for the payment of administrative expenses, depending on whether the plan proponent (typically the debtor) is aligned with the applicant. If the debtor does not support the applicant's request, the expense would be governed by section 503. If, however, the debtor does support the applicant's request—as would often be the case with estate professionals, insiders or creditors from whom the debtor has extracted some important concession, as in *Adelphia*—a debtor may bypass section 503 simply by declaring the payment to be an administrative expense under the plan. The agreed payment of administrative expenses under a plan would therefore remove those expenses from the reach of section 503.

This result vastly alters the entire statutory scheme of which section 503 is a part. The Bankruptcy Code's system of priorities binds both creditors and debtors and cannot be altered by the court.[13] While courts have a certain amount of discretion in determining whether an obligation fits into one of the administrative expense categories of section 503, they do not have the discretion to ignore or reorder those categories.[14] Moreover, despite *Adelphia's* suggestion that section 503 is concerned only with the non-consensual payment of administrative expenses,[15] many provisions of that section govern voluntary payments by debtors. For instance, subsection (b)(1) is directed primarily at the fee requests of estate professionals, to which debtors rarely object.[16]

Moreover, if section 1123 authorizes a plan proponent to bypass the statutory criteria for a substantial contribution, a plan presumably might evade other specific limitations of section 503. For example, section 503(b)(7) caps the rent that may be claimed under a lease that is assumed and subsequently rejected. Similarly, in section 503(b)(4), Congress clarified that attorneys who represent individual members of a committee (as opposed to the committee as a whole) cannot be paid from the estate.[17] If future courts construe the holding in *Adelphia* broadly, plan proponents could seek to avoid these statutory limitations.

Do *Adelphia* Settlements Violate the Law?

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[13] 4 Collier on Bankruptcy ¶ 503.03[7] (16th ed. 2010); *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004), *cert. denied*, 543 U.S. 995 (2004).
[14] 4 Collier on Bankruptcy ¶ 503.05[2] (16th ed. 2010).
[15] *Adelphia*, 441 B.R. at 12 (describing section 503(b) as "nonconsensual in nature").
[16] *In re Busy Beaver Bldg. Centers, Inc*., 19 F.3d 833, 842 (3rd Cir. 1994) (observing that "objections to fee applications by parties other than the UST are also relatively uncommon").
[17] 11 U.S.C. § 503(b)(3)(F), (b)(4); *see generally In re Summit Metals, Inc.*, 379 B.R. 40 (Bankr. D. Del. 2007), *aff'd,* 406 Fed. App'x 634 (3rd Cir. 2011) (denying committee chairman's fee request for legal services he provided to himself).

To confirm a plan, a court must affirmatively find that the plan has been "proposed in good faith and not by any means forbidden by law."[18] Similarly, if a plan proponent induces a creditor to vote in favor of a plan in bad faith or through illegal means, that creditor's vote may be subject to disqualification.[19] Although there was and is no suggestion whatsoever that *Adelphia* itself involved any improper or illegal conduct, any future plan resembling *Adelphia* will require an inquiry into whether the settlement between the plan proponent and the creditors crossed the line separating proper conduct from improper conduct.

The Bankruptcy Code and Bankruptcy Rules reflect a strong public policy favoring settlements.[20] An individual reward given upon the withdrawal of a plan objection or a competing plan may or may not be a legitimate settlement, but distinguishing between legitimate compromise and illicit conduct can require complex, subjective judgments about the parties' motives. For example, a promise to pay attorneys' fees could induce a committee member to violate its fiduciary duty to its constituency or an attorney to violate a duty to his client. In other cases, a party might offer to pay a party's attorneys' fees to withdraw an objection as part of an effort to cover up wrongdoing or to defeat a provision of the Bankruptcy Code.[21] In these examples, the difference between legal and illegal conduct depends on the parties' subjective intent—something that most courts are ill-positioned to determine. The inability or unwillingness to consider these issues creates a danger that *Adelphia* settlements could become a vehicle for fraud or abuse.

Do *Adelphia* Plans Discriminate?

Although it is theoretically possible that an *Adelphia* plan provision could pay an equal amount of fees to all creditors within a class, as a practical matter it is more likely that a plan would reward only a narrow subclass of creditors within a class—such as members of official or *ad hoc* committees or creditors who have been particularly active or influential objectors. Moreover, even if the fees are technically awarded to the attorneys and not the creditors, if they relieve the creditor of its financial obligation to pay the attorney, they are properly considered a distribution to the creditor. Such a case would raise the question whether the provision to pay *Adelphia* fees violates section 1123(a)(4) of the Bankruptcy Code, which mandates that a plan provide the same treatment to all members of a particular class.[22]

There is some reason to believe that it does. Although no court has yet discussed section 1123(a)(4) in the context of a promise to pay a creditor's attorneys' fees, courts have long

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[18] This can include, among other provisions, 18 U.S.C. § 152(6) (making it a criminal offense to "knowingly and fraudulently" provide or receive "money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11").
[19] 11 U.S.C. § 1126(e).
[20] Fed. R. Bankr. P. 9019.
[21] *In re Kallstrom*, 298 B.R. 753 (B.A.P. 10th Cir. 2003) (noting that settlement in which creditor was paid to withdraw objection to discharge "may be criminal" under 18 U.S.C. § 152(6)).
[22] 11 U.S.C. § 1123(a)(4).

recognized that the Bankruptcy Code does not permit plans to provide benefits to particular creditors on terms not available to the entire creditor class.[23] Based on this reasoning, if a plan proposes to pay attorneys' fees only to select creditors within a single class, whether that plan complies with section 1123 is questionable.

Measuring Reasonableness

Finally, pursuant to section 1129(a)(4), any fees awarded must be "reasonable."[24] The text of section 1129(a)(4), however, offers no guidance on how, or in relation to what, the reasonableness of a fee should be measured.[25] In other settings, reasonableness under the Bankruptcy Code is generally measured in terms of a service's costs and benefits to the bankruptcy estate,[26] but that standard is not particularly relevant to *Adelphia* fees, which may have been incurred for activities that were adversarial or even injurious to the estate. [27]

In *Adelphia*, the court resolved this issue by equating "reasonableness" with whether any of the applicants' litigation behavior was "outrageous."[28] The court defined "outrageous" behavior, in turn, in terms of specific instances of "scorched earth" litigation tactics that were not unethical or sanctionable, but which the court believed "should [not] be encouraged or rewarded."[29] Thus, as a condition of receiving fees, the court required each fee applicant to certify that it was not requesting compensation for any of the disfavored tactics discussed by the court; all other fees were apparently approved as reasonable.[30] Whatever the merits of this highly case-specific approach in *Adelphia*, it provides little guidance and less certainty in future cases that may follow *Adelphia's* precedent.

Conclusion

The authors of the *Adelphia* plan were seemingly motivated by a sincere desire to bring a bitterly divided bankruptcy case to its conclusion under an unusual set of factual circumstances. But the ruling in *Adelphia* should be confined to the facts of that case, or the decision may raise more questions than it answered. The U.S. Trustee Program views *Adelphia* as a narrow decision that should be conservatively applied in future cases.

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[23] *See, e.g.*, *In re Finova Gp., Inc.*, 304 B.R. 630 (D. Del. 2004) (section 1123(a)(4) did not permit debtor to reimburse bank utilization fees to some, but not all, creditors within class); *In re Union Meeting Partners*, 165 B.R. 553 (Bankr. E.D. Pa. 1994) (section 1123(a)(4) violated where plan offered bonus to unsecured creditors, but set disparate requirements for eligibility to receive bonus).

[24] 11 U.S.C. § 1129(a)(4).

[25] 7 Collier on Bankruptcy ¶ 1129.02[5] (15th ed. 2009) (describing section 1129(a)(4) reasonableness standard as "open ended" and "potentially ambiguous").

[26] *In re Pro-Snax Distributors, Inc.*, 157 F.3d 414 (5th Cir. 1998) (standard for whether fees are "reasonable" under 11 U.S.C. § 330 is whether they "resulted in an identifiable, tangible, and material benefit to the bankruptcy estate").

[27] *Adelphia*, 441 B.R. at 20.

[28] *Id.*

[29] *Id.*

[30] *Id.* at 23.