KIRKLAND & ELLIS LLP

KIRKLAND ALERT

October 2009

Substantial Contribution Claims Require Intent to Benefit Estate

Introduction

A bankruptcy court may reward a party that makes a "substantial contribution" to a chapter 11 case by ordering the debtor to pay the party's fees and expenses incurred in making that contribution under Section 503(b)(3)(D) of the Bankruptcy Code. Section 503(b)(3)(D) reflects a policy of encouraging meaningful participation in a reorganization case, while "keeping fees and administrative expenses to a minimum so as to preserve as much of the estate as possible for the creditors."[1]

The Bankruptcy Code does not define "substantial contribution." Courts generally have required that the claimant show that it took "extraordinary actions" that led to an actual and demonstrable (or, as some courts say, a "direct and material") benefit to the debtor's estate.[2] The courts are divided, however, regarding whether the claimant's intent to benefit the estate is relevant. Bankruptcy courts in the District of Delaware and the Southern District of New York, among others, generally require a claimant to show that its actions were intended to benefit the estate and will not allow a substantial contribution claim where the benefit was incidental to the claimant's pursuit of its own self interest.[3] As parties in a bankruptcy proceeding are generally presumed to act in their own self interest, this standard sets a high bar to proving a substantial contribution claim.

A recent ruling by the Delaware bankruptcy court overseeing Tropicana Entertainment's chapter 11 cases illustrates the difficulty of obtaining a substantial contribution claim when the claimant's intent to benefit the estate is at issue.

The Tropicana Case

Tropicana Entertainment and 33 of its affiliates filed for chapter 11 after the New Jersey Casino Control Commission denied Tropicana's state gaming license applications and appointed a conservator to operate Tropicana's Atlantic City casino. The day after Tropicana filed for bankruptcy, a consortium of Tropicana's unsecured bondholders sought the appointment of a chapter 11 trustee. The consortium alleged that an individual who was Tropicana's owner, CEO, and board chairman had mismanaged Tropicana, resulting in the gaming license denials and loss of control of the Atlantic City casino, and that this mismanagement constituted "cause" to appoint a trustee.

The parties settled during trial. Under the settlement, the owner agreed to resign from the Tropicana board, give up his officer position, and grant Tropicana's remaining board members a limited, irrevocable proxy. The settlement also required Tropicana to support the consortium's claim that its attorney's fees and expenses incurred in bringing the trustee motion constituted a "substantial contribution" to Tropicana.

The Substantial Contribution Application

After the bankruptcy court confirmed Tropicana's plans of reorganization, the consortium filed a substantial contribution application for allowance of approximately $2.4 million in attorney's fees and expenses. Tropicana's secured lenders opposed the application. The lenders argued that the consortium was motivated by a de-

sire to protect its own self interest because, at that time, it appeared that the bondholders would be the fulcrum constituency and would own reorganized Tropicana. The lenders also argued that any incidental benefit to the estate that may have resulted from the settlement was insufficient to demonstrate the consortium's intent to benefit all creditors, as required by the controlling Third Circuit precedent on the issue, *Lebron v. Mechem Financial, Inc.*[4]

The bankruptcy court agreed with the lenders and denied the application. While acknowledging that removing the owner had benefited the estate, the bankruptcy court stated that this benefit alone was not enough to warrant a substantial contribution claim under the *Lebron* intent standard. "The exercise here," the judge stated in ruling from the bench, "is to separate out the self-interest and to see what else might warrant an award for a substantial contribution. . . . [A]nd I'm not convinced [with respect to] that element laid out by the [Third] Circuit in *Lebron* relating to whether the movants would have moved forward absent an expectation of reimbursement from the estate or not, they just haven't met that burden."[5]

In particular, the bankruptcy court noted the consortium's failure to offer any evidence that it acted out of anything other than self interest and observed that the consortium "had such a bloodlust for [the owner], that it would have [proceeded] to do what [it] did regardless of whether there was a benefit shared by others who were constituents in the estate." The bankruptcy court also refused to grant any weight to Tropicana's "support" for the application under the terms of the settlement, saying "[i]t was part of a settlement, which I will tell you it's my impression was wrested from the debtor and its owner."[6]

Potential Impact on Parties Seeking Substantial Contribution Awards

The consortium has appealed the bankruptcy court's ruling, and while the decision does not signal a change in the law, it does demonstrate the difficulties a party faces in seeking a substantial contribution award in a jurisdiction where the party's intent is relevant. It also illustrates the importance of building a record demonstrating that the party's actions were intended to benefit the debtor's estate, and not merely to advance its own interests, and that the claimant would not have acted without an expectation of reimbursement from the estate.

Kirkland & Ellis LLP represents the Tropicana debtors in possession in their chapter 11 cases.

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1 *Otte v. United States*, 419 U.S. 43, 53 (1974).

2 *See, e.g., Lister v. United States*, 846 F.2d 55 (10th Cir. 1988).

3 *See, e.g., In re Granite Partners, L.P.*, 213 B.R. 440, 446 (Bankr. S.D.N.Y. 1997).

4 *Lebron v. Mechem Fin., Inc.*, 27 F.3d 937 (3d Cir. 1994).

5 Transcript of Proceedings Before the Honorable Kevin J. Carey, United States Bankruptcy Court Judge at 29-39 and 56, *In re Tropicana Entermn't, LLC*, Case. No. 08-10856 (KJC) (Bankr. D. Del. Sept. 10, 2009).

6 *Id.* at 46.

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