

Substantial contribution: a new decision from the 3rd Circuit

By Daniel A. Lowenthal, Esq., Patterson Belknap Webb & Tyler LLP*

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It's often hard to persuade a bankruptcy court to grant a motion for substantial contribution. Any attorney thinking about making a motion should first ask herself two questions.

First, has my work benefitted both my client and other creditors? Second, did my work result in more than an incidental benefit to the bankruptcy estate? If the answer to either question is no, then the attorney should forget about making the motion. The time spent on it will be wasted, and the motion will be denied.

And even if the attorney can answer both questions in the affirmative, she should still spend time figuring out how she will demonstrate that other creditors and the bankruptcy estate benefitted from her work. For good reason, courts presume an attorney's work is motivated by self-interest for the client. Proving that work was also done for other creditors and a bankruptcy estate is not an easy task.

Consider a recent Third Circuit decision, where an attorney's request for fees was denied. *In re American Center for Civil Justice, Inc.*¹ Years before the debtor (ACCJ) filed for bankruptcy, it had entered into a contract with another entity (RLT). Both ACCJ and RLT were not-for-profit corporations with similar missions. In 2018, ACCJ filed for chapter 11.

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ACCJ scheduled RLT with an undisputed \$14.8 million claim that was related to their contract. Certain of ACCJ's creditors moved to disallow the claim on the grounds of fraud, breach of fiduciary duty, and alter ego. Both ACCJ and RLT defended the claim using their own counsel.

RLT later filed its own chapter 11 case. The attorney who represented RLT in the ACCJ case sought to represent RLT in its bankruptcy case.

When the RLT case was filed, the attorney was owed approximately \$97,000 for his work for RLT in the ACCJ case. The U.S. Trustee objected to the attorney's retention application on the ground that the attorney wasn't a disinterested person.

Section 503(b)(3)(D) allows a creditor to recover the "actual, necessary expenses" it incurred "in making a substantial contribution in a case under chapter ... 11 of this title."

To resolve the objection, the attorney agreed to waive claims to the \$97,000. But the bankruptcy court in the RLT case allowed counsel to pursue a substantial contribution claim for the \$97,000 against the ACCJ estate. Perhaps it seemed like a good idea at the time, but it didn't work. The court in ACCJ denied the request, and the district court affirmed. The attorney appealed to the Third Circuit.

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Substantial contribution claims are governed by section 503(b) of the Bankruptcy Code. Specifically, section 503(b)(3)(D) allows a creditor to recover the "actual, necessary expenses" it incurred "in making a substantial contribution in a case under chapter ... 11 of this title." Section 503(b)(4) allows payment of "reasonable compensation for professional services rendered by an attorney ... of an entity whose expense is allowable under [11 U.S.C. section 503(b)(3)(D).]"

Creditors can rebut the presumption that they acted in their own self-interest by demonstrating their efforts (i) "resulted in an actual demonstrable benefit to the debtor's estate and the creditors,"

and (ii) the benefit to the estate was not “incidental” to the work.² A showing must be made that the “actions were designed to benefit others who would foreseeably be interested in the estate.”³

In the ACCJ case, the attorney seeking fees argued that he worked with the ACCJ debtor to defeat allegations of “fraud, breach of fiduciary duty, and [alter ego] as a basis to disallow the RLT claim.” Thus, the argument went, the ACCJ estate and its creditors benefitted from this work.

But, in a decision labeled as “not binding precedent,” the Third Circuit affirmed the lower courts’ rulings that the attorney hadn’t made the necessary showing of substantial contribution. The court held that, although RLT had an interest in establishing the validity of its claim, that interest didn’t impact the substantial contribution analysis. Instead, the Third Circuit ruled that if there was a related

benefit to the ACCJ bankruptcy estate at all from RLT’s attorney’s work, any such benefit was “incidental.”

The Third Circuit’s ruling also relied on a key finding by the district court. “Nothing in the record suggests that [the attorney] consulted with other creditors of ACCJ or otherwise acted for the benefit of creditors as a whole.”⁴ Therefore, the attorney’s effort to get paid the \$97,000 from the ACCJ estate by way of substantial contribution was denied.

Notes

¹ No. 22-1016, 2022 WL 17884119 (3d Cir. Dec. 23, 2022). <https://bit.ly/3XjRr43>

² 2022 WL 17884119, at *6 (quoting *Lebron v. Mechem*, 27 F.3d 927, 946 (3d Cir. 1994)).

³ *Id.*

⁴ 2022 WL 17884119, at *7-8.

About the author



Daniel A. Lowenthal is a partner at **Patterson Belknap Webb & Tyler LLP** in New York City and chair of the firm’s business reorganization and creditors’ rights group. He represents creditors’ committees, bondholders and other creditors, indenture trustees, liquidating trustees, and examiners in domestic and international cross-border cases. He can be reached at dalowenthal@pbwt.com. This article was originally published Jan. 4, 2023, on the firm’s Bankruptcy Update Blog. Republished with permission.

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