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UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE

NOV 09 1998

JED G. WEINTRAUB
CLERK OF COURT
WESTERN DISTRICT OF TENN.

IN RE
ENCAPSULATION INTERNATIONAL, INC.,
Debtor.

Case No. 96-31762whb
Chapter 11

MEMORANDUM OPINION AND ORDER
ON CREDITORS' MOTIONS FOR § 503(b) FEES AND EXPENSES

JUDGE WILLIAM HOUSTON BROWN

APPEARANCES:

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Before the Court are the applications of creditors and their attorneys, Zanaki L.L.C. (docket entry 203), Dam Investments, Inc. (docket entry 182), and C. William Denton and The Bogatin Law Firm (docket entry 194) for administrative expense claims under 11 U.S.C. § 503. Each of the applications refer specifically to § 503(b)(3)(D)'s allowance of such claims when a creditor has made a "substantial contribution in a case." Objections to the applications have been filed by the United States Trustee, some unsecured creditors, and certain "unit holders" of the debtor. Moreover, the United States Trustee's objections are supported by affidavits of Charles J. Worrel, the debtor's operating manager during this chapter 11. The case has now produced a confirmed plan of liquidation under which the debtor sold its assets to Baker Hughes INTEQ. The Court has conducted a hearing, at which the applicants were given an opportunity to put on proof that would carry their burden of showing the required "substantial contribution," and the Court has reviewed each of the applications, objections and related pleadings. In addition, this Judge has personal knowledge of the involvement of the applicants in this case, knowledge gained from the applicants' participation or lack thereof in pleadings and hearings.

The applicable Bankruptcy Code section is § 503(b)(3), which permits "the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by--(D) a creditor...in making a substantial contribution in a case under chapter 9 or 11 of this title...." Moreover, § 503(b)(4) permits the allowance of "reasonable compensation for professional services rendered by an attorney or accountant of an entity whose expense is allowable under paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant."

Although the parties admit that the confirmed plan did not generate sufficient cash to fund the payment of all administrative expenses sought in this case, the applicants have consented to payment of less than all at this time, with the hope that the long-term plan provisions will satisfy their administrative claims.’ The allowance of administrative expense claims, of course, moves such claims into a first priority above all other creditors. 11 U.S.C. §507(a)(1).

Application of Dam Investments, Inc.

The application of Dam Investments, Inc. seeks administrative expense priority for its attorneys’ fees of \$56,313.23 and expenses of \$2,040.82, all related to services provided to this creditor by its attorney Henry C. Shelton, III and his firm Krivcher Magids, PLC. The application recites that it would be supplemented with a request for reimbursement of the fees and expenses charged by another attorney, Bruce M. Kahn; however, the Clerk’s docket report indicates no supplement to the original application. The Court, therefore, has no record before it upon which to approve any administrative claim concerning Mr. Kahn’s work. Based upon the Court’s analysis of Mr. Shelton’s time records and the Court’s view that “substantial contribution” fees and expenses must be allowable only upon the specific time or expenses that support such a contribution, the Court will allow a partial administrative claim to Dam in the amount of \$10,185.41, and the reasons for that allowance will be discussed below.

The confirmed plan, and the primary parties’ agreement, provided that \$150,000 of the initial payment from the purchaser of the debtor’s assets would be applied pro rata to allowed administrative claims, ‘with the balance of the deposit, \$100,000, going pro rata to unsecured creditors. Since Zanaki and Dam are the principal unsecured creditors, they will share the bulk of the \$100,000, in effect reimbursing them for some of the amounts asserted in their administrative claim applications.

Application of C. William Denton and The Bogatin Law Firm

In contrast to Mr. Shelton's participation, Mr. Denton did not stay for the duration of the hearing on these applications and did not put on any proof other than his filed application and supporting itemization of time. Moreover, Mr. Shelton "stayed the course" in this case more than did other creditors' counsel, a statement not to be taken as a criticism of anyone else. Mr. Denton represented the creditor Zanaki, L.L.C., and the Court recalls that Mr. Denton's active involvement ceased before the negotiations with the debtor reached their critical stage, by which time Mr. Shelton was appearing unofficially for Zanaki. Mr. Denton's time records supporting his application ended on December 15, 1997. The application itself states that only "\$5,000 was directly related to planning, drafting, finalizing, and adjusting the Creditors' Plan," a reference to a competing plan that was tiled by the principal creditors Dam and Zanaki. The application does not demonstrate that Mr. Denton made a substantial contribution to the confirmed plan, other than the inferences that the Court may make concerning the contributory effect of the competing plan effort. The Court does not doubt that Mr. Denton's work contributed to the overall reorganization effort; however, there is insufficient proof for the Court to allow an administrative claim. Mr. Denton's time appears to be more directly related to work solely on behalf of his client Zanaki than as a "substantial contribution" to this case.

Application of Zanaki, L.L.C

In addition to the application of its attorney, Zanaki filed its own administrative application, under the signature of its managing partner John E. Belda. Mr. Belda is an attorney, but he did not appear as such in this case. The application is for \$30,149.99, which includes the fees charged to Zanaki by Mr. Denton's law firm. The remainder of the application is for Mr. Belda's travel

expenses and for telephone charges. There is no proof to support a finding that Zanaki made a “substantial contribution” to this case, and the Court will deny Zanaki’s administrative claim

Discussion

As the United States Trustee points out, a finding of entitlement under § 503(b)(3)(D) is a prerequisite to an allowance under § 503(b)(4). *In re American Preferred Prescription, Inc.*, 194 B.R. 721, 724 (Bankr. E.D. N.Y. 1996). The Bankruptcy Code does not define “substantial contribution” nor does it set forth criteria to evaluate the same; rather, whether an applicant has shown “substantial contribution” is fact intensive, determined upon a case-by-case analysis. Lawrence P. King, *COLLIER ON BANKRUPTCY* 1 5TH ED. REV'D ¶ 503.10[5][a] (1998). Because it is typically presumed that a creditor acted in its own interest in a chapter 11 case, the applicant for administrative expense priority must carry the burden of proof, by a preponderance of the evidence. *Id.* “Nearly all cases have held that the contribution must provide tangible, clearly demonstrable benefits to the estate. An entity’s active participation in the case, even if considerable in terms of time, effort, and expense, and even if positive for the overall outcome, will not of itself be sufficient to constitute a substantial contribution.” *Id.*

At least one of the applicants reminds the Court that it has broad discretion to allow §503(b) administrative claims. This is correct, but discretion must recognize that “narrow construction of § 503(b) remains the guiding principle.” William L. Norton, Jr., *NOR-I-ON BANKRUPTCY LAW AND PRACTICE* 2D, §42.13 (1997). “The [overall] justification [for both allowing and limiting administrative claims] is that administrative claims should be allowed to the extent that they may redound to the benefit of the general creditors and the estate.” *Id.* In this context, whether a creditor has made a “substantial contribution” to a chapter 11 case is a fluid concept, dependent upon the

particular facts and circumstances of each case. The “shall” language of § 503(b) limits the court’s discretion on allowance of administrative claims, after the applicant has demonstrated “substantial contribution.” *Hall Financial Group, Inc. v. DP Partners Ltd. Partnership (In the Matter of DP Partners Ltd. Partnership)*, 106 F.3d 667, 670-71(5th Cir. 1997), *cert. denied*, 118 S.Ct. 63 (1997).

As stated previously, the term is not defined in the Code, and legislative history merely defines it negatively, “as not requiring ‘a contribution that leads to confirmation of a plan, for in many cases, it will be a substantial contribution if the person involved uncovers facts that would lead to a denial of confirmation.’” **NORTON BANKRUPTCY LAW AND PRACTICE** 2D, at § 42.27. “At the very least, parties attempting to secure § 503(b)(3)(D) priority should be able to demonstrate with some particularity the benefits accruing to the estate as a result of [their] actions.” *Id.*

In their determinations of “substantial contribution,” courts have traditionally applied such factors as

- 1) whether the services were rendered solely to benefit all parties in the case or just the client;
- 2) whether the services provided a direct, significant, and demonstrable benefit to the estate; and
- 3) whether the services were duplicative of services rendered by the attorneys for the [creditors’] committee, the committee itself, or the debtor and its attorneys.

In re Envirodyne Indus., Inc., 176 B.R. 8 15, 8 18 (Bankr. N.D. Ill.1995)(citations omitted). Such factors recognize that “substantial contribution” “encourage[s] participation by creditors in the reorganization process, but [does] not encourage mushrooming administrative expenses.” *Id.* Ultimately, “[c]ompensation under § 503(b) must be preserved for those rare occasions when the creditor’s involvement truly fosters and enhances the administration of the estate.” *Id.*

Recently, the Circuit Courts that have addressed “substantial contribution” have seen a

refinement in the interpretations of that term, in that the Fifth Circuit, in 1997, rejected the Third and Tenth Circuits' definitions of substantial contribution under 11 U.S.C. § 503(b). See, *Hall Financial Group, Inc. v. DP Partners Ltd. Partnership (In the Matter of DP Partners Ltd. Partnership)*, 106 F.3d 667 (5th Cir. 1997) (rejecting *Lebron v. Mechem Financial Inc.*, 27 F.3d 937 (3d Cir. 1994) and *In re Lister*, 846 F.2d 55, 57 (10th Cir. 1988)). The Third and Tenth Circuits' definitions distinguished between direct and indirect benefits and inquired into the applicant's motivation for rendering services: Any indirect benefits resulting from the applicant's work which either advanced his own interests or arose out of his motivation to benefit himself were not substantial contributions. The Tenth Circuit in *In re Lister* allowed administrative expenses only for work which was intended to benefit the estate and which directly benefitted it. "Efforts undertaken by a creditor solely to further his own self-interest, however, will not be compensable, notwithstanding any incidental benefit accruing to the bankruptcy estate." 846 F.2d 55 at 57. The Third Circuit followed *Lister* in *Lebron*, which awarded administrative priority status only for work which "directly and materially contributed' to the reorganization." 27 F.3d 937 at 943 (citations omitted). However, *Lebron* recognized that most efforts benefitting an estate would also benefit the creditor-applicant, and that Court concluded that. "the existence of a self-interest cannot in and of itself preclude reimbursement." *Id.* at 944.

The Fifth Circuit rejected the dichotomy between direct and indirect benefits and eliminated the applicant's self-motivation as a factor in the substantial contribution test. The *DP Partners' Court* noted "that nothing in the Bankruptcy Code requires self-deprecating, altruistic intent as a prerequisite to recovery of fees and expenses under section 503," *id.* at 673, and concluded that the "benefits, if any, conferred upon an estate are not diminished by selfish or shrewd motivations." *Id.*

at 672. Seeking a definition of “substantial contribution,” the Court employed the ordinary meaning of the term found in Webster’s Dictionary: “contribution that is ‘considerable in amount, value or worth.’” *Id.* at 673 (quoting **WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY** 2280 (4th Ed. 1976)). Using this definition, the Court announced a balancing test which “weigh[s] the cost of the claimed fees and expenses against the benefits conferred upon the estate which flow directly from those actions. Benefits flowing to only a portion of the estate or to limited classes of creditors are necessarily diminished in weight.” *Id.* at 673.

After consideration of these views of “substantial contribution,” this Court agrees with the Fifth Circuit’s *DP Partners*’ holding that a creditor’s self-interest motivation is not a *per se* bar to allowance of § 503(b)(3)(D) or (b)(4) administrative fees or expenses. The ultimate question is whether the creditor’s contribution was “substantial,” and a contribution may be such despite its self-serving nature. A creditor may surely benefit itself while it is benefitting the estate through its substantial efforts; otherwise, it would be unlikely that a creditor could ever meet the “substantial contribution” test. At the same time, the bankruptcy court may consider whether the benefit to the estate is incidental rather than substantial in making its determination of allowance. It is implicit in the directive of the statute that only a portion of a creditor’s administrative claim may satisfy the “substantial contribution” requirement; in other words, it is not an all-or-nothing allowance issue.

In this case, the Court has evaluated the administrative claims of Zanaki, Mr. Denton, and Dam. As previously noted, there is no proof, nor Court knowledge, of a “substantial contribution” by either Zanaki or Mr. Denton; thus, their administrative expense claims will be denied.

The Court is persuaded, however, that Dam has an allowable administrative expense claim for a portion of Mr. Shelton’s fees. This determination is based, in part, upon a review of Mr.

Shelton's itemized fee statement, as well as upon Mr. Shelton's statements in open court, but the determination is based in large part upon the Court's own knowledge from pleadings and hearings in this case. This case would not have reached confirmation without Mr. Shelton's contribution. The debtor's first disclosure and plan efforts, while well-intentioned, were doomed to failure. Confirmation required consent, as it is doubtful that this debtor could have satisfied the cram down requirements of § 1129(b). The confirmation prospects took a positive turn when Mr. Shelton drafted what would become a joint disclosure statement and engaged in meaningful negotiations with the debtor's attorney that resulted in a consensual plan of liquidation. It is true, as the United States Trustee's objection points out, that the confirmed plan was beneficial to Mr. Shelton's client, in that it treated Dam and Zanaki like other unsecured creditors. The point is, however, that treating those principal unsecured creditors in any other way, absent their consent, would have been unfairly discriminatory and would not have been "fair and equitable," thus violative of §1129(b)(1)'s basic requirements. Mr. Shelton's efforts, therefore, brought the debtor and the principal creditors to the point of agreement that appears to be the only achievable path that would result in a confirmed plan rather than a dismissal or conversion of the case--the consensual path. This Court surely should consider the results in making a "substantial contribution" analysis.

Having found that Mr. Shelton substantially contributed to the confirmation in this case, his full fee is not necessarily allowed as an administrative expense. After a review of his time records, the following references to tabbed itemizations accompanying Dam's application are found to be hours that made a substantial contribution to this estate:

Tab 1----No hours

Tab 2-----No hours

- Tab 3-----No hours
- Tab 4-----3.0 hours of plan work
- Tab 5-----4.0 hours of plan work
- Tab 6-----5.0 hours of disclosure and plan work
- Tab 7-----5.0 hours of disclosure and plan work
- Tab 8-----7.0 hours of disclosure and plan work
- Tab 9-----12.0 hours of disclosure and plan work
- Tab 10-----7.0 hours of disclosure and plan work
- Tab 11-----4.0 hours of plan and confirmation work

Total time allowed as an administrative expense is 47 hours at \$195.00 per hour, which the Court finds to be a reasonable rate for an attorney of Mr. Shelton's experience, or \$9,165.00. The Court will allow one half of the total requested expenses, or \$1,020.41, as an administrative expense.

IT IS THEREFORE ORDERED, based upon these findings and conclusions, that the administrative expense claims of Zanaki L.L.C., and of C. William Denton and The Bogatin Law Firm are denied, as not having been shown to be a "substantial contribution" to this estate. The objections to these administrative claims are sustained. This denial is without prejudice to these amounts being part of the unsecured claim of Zanaki if the parties' agreement so provides..

IT IS FURTHER ORDERED that the claim of Dam Investments, Inc. is partially allowed, in that \$9,165.00 in attorney fees and \$1,020.41 in expenses are given administrative expense priority under 11 U.S.C. § 503(b)(3)(D) and (4). The balance of Dam's application is denied administrative expense priority, without prejudice to Dam claiming this balance as a part of its unsecured claim if the parties' agreement so provides.

SO ORDERED this November 9, 1998.

[Handwritten Signature]
 UNITED STATES BANKRUPTCY JUDGE

Mailed on 10/10/98 to:

- Debtor, debtor's attorney, and trustee
 - Above listed parties
- Nancy Cannon, Administrative Secretary
 United States Bankruptcy Court