



Third Circuit Affirms Denial of Substantial Contribution Claim and Reaffirms *Lebron* Test

Lee E. Kaufman

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In a recent decision in *In re Tropicana Entertainment*, the U.S. Court of Appeals for the Third Circuit affirmed the denial of a substantial contribution claim filed by the Ad Hoc Consortium of Senior Subordinated Noteholders. In so doing, the Third Circuit reaffirmed the test set forth in *Lebron v. Mechem Financial*, 27 F.3d 937 (3d Cir. 1997), and reiterated that reimbursement for substantial contribution is inappropriate if the activities of creditors or other interested parties are designed primarily to serve their own interests. Although a nonprecedential decision, the Third Circuit's *Tropicana* opinion provides valuable insight into the court's application of the substantial contribution test set forth in *Lebron*.

On May 5, 2008, Tropicana Entertainment and related entities filed voluntary Chapter 11 petitions in Delaware. The next day, the consortium filed an emergency motion for the appointment of a Chapter 11 trustee, alleging gross mismanagement of Tropicana by Chief Executive Officer William Yung that, if left unchecked, allegedly would reduce the value of Tropicana's bankruptcy estates. Several parties, including the Official Committee of Unsecured Creditors, joined the trustee motion. Following two months of expedited litigation, a settlement was ultimately reached regarding the trustee motion, pursuant to which Yung withdrew from Tropicana's management and no Chapter 11 trustee was appointed. The settlement agreement included a clause in which Tropicana acknowledged that expenses incurred by the consortium in prosecuting the trustee motion "represent a substantial contribution to [Tropicana's] estate."

Thereafter, the consortium filed an application with the Bankruptcy Court for reimbursement of \$2.4 million in legal fees incurred in connection with its prosecution of the trustee motion, arguing that its efforts represented a substantial contribution to Tropicana's estate pursuant to 11 U.S.C. §§503(b)(3)(D) and (b)(4). The Bankruptcy Court denied the application in its entirety, notwithstanding the acknowledgement in the settlement agreement that the consortium's efforts "represent a substantial contribution" to Tropicana's estate. The Bankruptcy Court noted that the consortium had submitted no evidence in support of its request, and concluded that although the trustee motion "turned out to have a beneficial effect on the estates," the "action [of prosecuting the trustee motion] was taken largely in the self-interest of the [consortium] and would have been taken whether there would have been estate reimbursement or not." On appeal, the Delaware District Court affirmed the decision of the Bankruptcy Court by a memorandum order dated September 2, 2010. Consequently, the consortium appealed to the Third Circuit.

In the Third Circuit, the test regarding whether an entity has made a "substantial contribution" pursuant to Section 503(b)(3)(D) of the Bankruptcy Code was established by *Lebron*. "The applicable test is whether the efforts of the applicant resulted in an actual and demonstrable benefit to the debtor's estate and the creditors." In addition, "'substantial contribution' should be applied in a manner that excludes reimbursement in connection with activities of creditors and other interested parties which are designed primarily to serve their own interests and which, accordingly, would have been undertaken absent an expectation of reimbursement from the estate."

On appeal to the Third Circuit, the consortium argued that the Bankruptcy Court misapplied the substantial contribution test set forth in *Lebron* by characterizing a creditor's "expectation of reimbursement" as a necessary element of the substantial contribution test and by focusing solely on whether the consortium had an expectation of reimbursement when it filed the trustee motion. The Third Circuit disagreed with this characterization, finding that although the Bankruptcy Court noted in denying the application that the consortium would have filed the trustee motion "whether there would have been estate reimbursement or not," the Bankruptcy Court was not attempting to establish the expectation of reimbursement as a necessary element of the substantial contribution test. Rather, the Third Circuit found that because the consortium presented no evidence that it would not have prosecuted the trustee motion absent the promise of reimbursement by the estate, the Bankruptcy Court determined, as a factual matter, that the consortium failed "to overcome the presumption that it had acted in its own self-interest." Accordingly, the Third Circuit found that the Bankruptcy Court properly applied, and did not modify, the substantial contribution test established by *Lebron*.

Although nonprecedential, the Third Circuit's decision in *Tropicana* is valuable in that it reaffirms the substantial contribution test set forth in *Lebron* and provides insight into the court's application of the test. Moreover, it serves as a reminder to any party seeking approval of a substantial contribution claim that it must present adequate evidence to demonstrate that not only did its efforts result in an actual and demonstrable benefit to the debtor's estate, but also that it was not acting primarily to serve its own interests. Such a showing could be made by, inter alia, presenting evidence that the party would not have acted absent an expectation of reimbursement by the debtor's estate.

Lee E. Kaufman is an associate at *Richards, Layton & Finger*. He represents debtors, secured creditors and other parties in interest in Chapter 11 cases and advises clients on litigation matters associated with preferential transfers, fraudulent transfers and other bankruptcy-related issues.

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