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Operating Expenses of Chapter 9 Municipal Debtor are not Administrative Expenses Protected by Section 503(b)

Creditors who regularly deal with Chapter 11 debtors take comfort in their ability to file an administrative expense claim, entitling their claim to higher priority, for goods or services provided to the debtor post-petition. According to a recent ruling by the Bankruptcy Court for the Southern District of New York, the same is not true in Chapter 9, the bankruptcy chapter for municipal debtors. In *In re Off-Track Betting Corporation*, the Bankruptcy Court for the Southern District of New York held that post-petition operating expenses of a Chapter 9 debtor are not administrative expenses under section 503(b) of the Bankruptcy Code. Case No. 09-17121 (MG) (Bankr. S.D.N.Y. Aug. 5, 2010).

In this case, the Finger Lakes Racing Association and Empire Resorts, Inc. (collectively, the “Tracks”) moved to compel the Off-Track Betting Corporation (“OTB”), a Chapter 9 debtor, to pay certain statutory commissions due under state law. The New York Racing, Pari-Mutuel Wagering and Breeding Law requires OTB to pay a portion of the funds it collects from betting activities to various stakeholders in the New York racing industry, including the Tracks. The plaintiff creditors argued that the statutory commissions were due under state law, and that the payments were “actual, necessary costs and expenses of preserving the estate” that were entitled to administrative priority under section 503(b) of the Bankruptcy Code. While the debtor acknowledged that the statutory payments were owed, it argued that state law was unclear as to *when* the payments had to be made. OTB also argued that the commissions were not entitled to administrative priority. Notably, OTB’s obligation to pay the statutory commissions was a key factor in its need to seek bankruptcy protection.

The Court declined to order payment of the statutory commissions as administrative expenses under section 503(b) of the Bankruptcy Code. Citing to a recent decision by the Bankruptcy Court for the Central District of California and certain bankruptcy treatises, the Court concluded that Chapter 9 does not incorporate section 541 of the Bankruptcy Code and therefore, unlike Chapter 11, does not provide for the creation of a bankruptcy “estate.” Since the granting of administrative expense priority under section 503 of the Bankruptcy Code is tied to “the actual, necessary costs and expenses of preserving the estate,” without an “estate,” there can be no grounds for administrative expense claims under section 503(b).

Rather, only expenses relating to the Chapter 9 process itself may be claimed as administrative expenses under section 503(b).

The Court further held that equity did not support ordering the immediate payment of the statutory commissions because the commissions did not result from any goods or services provided to OTB by the Tracks, and further ruled that it would abstain from establishing a payment schedule for the statutory commissions. However, the Court was sympathetic to the financial pressure placed on the Tracks because the OTB fees were not being paid and suggested that, if necessary, it would consider dismissing the Case for OTB's failure to complete a plan for the adjustment of its debts and to pay undisputed debts due during the administration of the bankruptcy case.

In this case, the Court's decision was driven in part by relatively unique facts – a creditor seeking payment of statutory commissions without a statutorily-established payment schedule, no clear pattern of historical payments, and unresolved legal issues. However, the decision also is an important reminder to all potential creditors in a municipal bankruptcy that due to the unique nature of these proceedings, and the different statutory provisions applicable to cases under Chapter 9 and Chapter 11 of the Bankruptcy Code, creditors may be afforded different, and more limited rights, in municipal debtor proceedings.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Bankruptcy and Restructuring in the "Practices" section of our website (<http://www.clearygottlieb.com>) if you have any questions.

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