

CLIENT ALERT

Entitlement to Attorneys' Fees in Bankruptcy by Unsecured Creditors Remains Uncertain

Dec.20.2007

Earlier this year, the U.S. Supreme Court addressed the issue of the collection of attorneys' fees in bankruptcy by unsecured creditors. In *Travelers Cas. & Sur. Co. of America v. Pacific Gas & Elec.*, --- U.S. ---, 127 S.Ct. 1199 (2007), the Supreme Court struck down the so-called "Fobian Rule" of the Ninth Circuit and held that a creditor was not precluded from filing an unsecured claim for contractual attorneys' fees merely by virtue of the fact that the fees sought had been incurred in litigating issues of federal bankruptcy law. Unfortunately, because the argument was not presented or considered below, the Supreme Court declined to resolve a split in authority over whether Section 506(b) of the Bankruptcy Code applied to prohibit all unsecured creditors with contractual rights to collect attorneys' fees and costs. As a result, indenture trustees and other unsecured creditors with contractual rights to collect attorneys' fees and costs must analyze their rights on a case-by-case basis, depending on the jurisdiction in which the bankruptcy case is pending.

In November 2007, the U.S. District Court for the Western District of Pennsylvania addressed the Section 506(b) issue. In *J.P. Morgan Trust Co., N.A. v. A.P. Green Indus., Inc.*, Civil Action No. 06-0885 (Bankr. Case No. 02-21626), Memorandum and Order (W.D. Pa. Nov. 5, 2007), ECF 20, www.pawd.uscourts.gov, the District Court followed the majority view and held that unsecured creditors are not entitled to enforce a contractual right to post-bankruptcy attorneys' fees and expenses as part of their claim against an insolvent estate. <

In the *A.P. Green* case, J.P. Morgan Trust Company was acting as an indenture trustee and filed a proof of claim in the bankruptcy proceeding for payment of, among other things, approximately \$30,000 for attorneys' fees, costs and expenses, plus an unliquidated claim for similar amounts to be incurred in the future. There was no question that J.P. Morgan was entitled to those fees and expenses under the bond trust indenture. However, debtor A.P. Green objected to the post-bankruptcy portion of the claim, arguing that an unsecured creditor cannot be paid such fees and expenses in bankruptcy.

In sustaining the objection and not allowing the claim, the Bankruptcy Court followed the majority view, which is based on four primary grounds. First, because Congress specifically authorized payment of post-petition attorneys' fees for oversecured creditors in Section 506(b) and was silent about such fees for unsecured creditors, the maxim of *expressio unius est exclusio alterius* (the expression of one is the exclusion of the alternatives) means there is no clear entitlement to such fees for unsecured creditors. Second, in its opinion in *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988), the U.S. Supreme Court found that only oversecured creditors (and not undersecured creditors) were entitled to post-petition interest. As a result, only oversecured creditors are entitled to post-petition fees under Section 506(b). Third, Section 502(b)'s requirement that the amount of a claim be determined "as of" the petition date means that no post-petition fees are permissible. Fourth, equity and policy considerations, such as unfairly discriminating against other unsecured creditors by reducing the pool of assets available, favor the decision to not allow contractual claims for attorneys' fees and costs.

On appeal, the District Court recognized there is no binding precedent in the Third Circuit on this issue and that other courts are divided on the issue. The District Court affirmed the Bankruptcy Court's decision. However, the District Court's opinion used the

four grounds supporting the majority view not as a basis for the decision itself, but instead to support the court’s statutory construction analysis.

Specifically, the District Court found that “unsecured contractual claims for attorneys’ fees and costs are not enforceable as a matter of statutory construction.” Because Section 506(b) refers only to interest, fees and costs “to the extent” of any security cushion, “by implication, [it] excludes the recovery of such fees and costs to the extent a creditor is undersecured, or unsecured.” *Id.* at p. 3. Next, the District Court observed that Section 506(b) speaks in terms of what the holder of a secured claim is entitled to. “The section does not provide the holder with any other rights or claims, such as an unsecured claim representing the portion of the claim that was undersecured.” *Id.* at p. 4. If Section 506(b) were to provide such a right, it would be duplicative of Section 506(a), which sets forth the general rule on claims. The District Court went on to disagree with J.P. Morgan’s argument that because an unsecured claim for contractual attorneys’ fees and costs is not excluded under Section 502(b), it must be allowed under Section 502(a), without reference to Section 502(b). Such an isolated reading of Section 502, the District Court determined, would lead to the “illogical result” of the holder of an unsecured claim for contractual attorneys’ fees and costs with more rights than the holder of an undersecured claim for the same amounts. In the end, the District Court found that the equities favored the result reached by the statutory interpretation. Specifically, and as noted by the Bankruptcy Court, “to allow contractual claims for attorneys’ fees and costs to accrue against the bankruptcy estate’s unencumbered assets would impair the debtor’s fresh start and interfere with a final discharge of all debts, while treating similarly situated creditors differently.” *Id.* at p. 5.

The *A.P. Green* decision is a reminder of the uncertainty surrounding whether unsecured creditors may enforce contractual rights to collect attorneys’ fees and costs. Until the issue is properly taken up to and decided by the Supreme Court, there is no uniform, binding precedent. The claims of unsecured creditors with such rights will be allowed or disallowed based on the law of the jurisdiction for each particular bankruptcy case.

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