



## Supreme Court Broadens Attorney Fees in Bankruptcy

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As a general rule, claims in bankruptcy are divided into two classes: (1) those for which the debtor has pledged some collateral (secured claims) and (2) those for which there is no collateral (unsecured claims). Within the subset of secured claims, there are those that are fully secured (*i.e.*, the collateral is worth more than the value of the claim, also sometimes called over-secured claims) and those that are only partially secured (*i.e.*, the creditor has collateral but the collateral does not have a fair market value equal to the claim, sometimes called an under-secured claim).



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Historically, if the bankruptcy was one for liquidation, a secured creditor could move to lift the stay and proceed against the collateral if the debtor did not “have an equity in” the collateral (11 U.S.C. § 362(d)(2)) – *i.e.*, if the claim was only partially secured. If the claim was fully secured and there was a prospect that sale of the collateral would bring more than the amount of the claim, the property would be sold by the trustee and the secured creditor would receive proceeds up to the amount of his secured claim, the remainder being available to the trustee for unsecured creditors. § 506.

If the bankruptcy was for reorganization, to lift the stay the creditor had to show not only that the debtor had no equity in the property, but also that it was “not necessary to an effective reorganization” (§ 362(d)(2)). If he could not meet those showings, he generally would receive under the Chapter 11, 12 or 13 plan, in lieu of the property, money equal to the value of his secured claim.

When the creditor was oversecured, ***unsecured creditors, the bankruptcy trustee, and the bankruptcy court had incentives to minimize the amount of the secured claim***, because the excess could go toward administrative expenses and some payment for the unsecureds. Moreover, claims generally were valued “as of the date of the filing of the [bankruptcy] petition” (§ 502). Thus, when a debtor filed for bankruptcy a secured creditor could file a claim for the amount of its debt plus interest and attorneys’ fees that had accrued until the time of the filing of the bankruptcy, and if he was fully secured he would eventually be paid the amount owed at the filing of the bankruptcy.

Moreover, if there was a contract clause giving a secured creditor a right to recover attorney fees, it often was interpreted to cover only state-law enforcement issues – not litigation in a bankruptcy matter. Thus, ***fees for litigation over bankruptcy matters were not recoverable from the property or even as unsecured claims – absent “bad faith or harassment”*** by the losing party, notwithstanding a contract clause allowing them. See *In re Fobian*, 951 F.2d 1149 (9th Cir. 1991); *In re DeRoche*, 434 F.3d 1188 (9th Cir. 2006).

In *Travelers Casualty & Surety Co. v. Pacific Gas & Electric Co.*, \_\_\_ U.S. \_\_\_, 127 S.Ct. 1199 (2007), the Supreme Court rejected this “Fobian Rule”. Writing for a unanimous Court, Justice Alito found there was no provision in the Bankruptcy Code forbidding the recovery of attorneys’ fees arising out of post-petition litigation in bankruptcy matters. The failure of the Code to have language prohibiting such recovery was fatal in the Court’s eyes, because “we generally presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed”.

Travelers’ claim for fees arose in a Chapter 11 reorganization where Travelers’ basic right to indemnity from the reorganized debtor was undisputed. PG&E urged the Court to rely on that provision, arguing that the absence of a comparable provision for unsecureds was dispositive. The Court refused.

**While Travelers thus did not address secured claims, its implications appear to be at least as strong for secured claims as for unsecured.** Thus, when a secured creditor is required to incur legal fees post-petition in order to protect its claim, no longer will those fees be objectionable just because the litigation addressed bankruptcy issues. If there is a contract clause which otherwise gives the creditor a right to attorney fees, the creditor now will have a significantly increased chance of recovering those fees.

Several observations can be offered. First, **in this context as in most others, the over-secured creditor is in the best position.** If the creditor is in that position, it and his counsel can negotiate from a stronger position pre-bankruptcy, can have better leverage in post-petition negotiations about the case, and can have a fair chance of recovering attorney fees incurred in protecting its collateral position if litigation in bankruptcy becomes necessary. To attain that position, however, puts a premium on careful preparation of contracts to insure that the content is consistent with *Travelers* and other applicable law.<sup>1</sup> A premium also will be placed on having knowledgeable bankruptcy counsel, both pre- and post-petition, to take advantage of the changed negotiation position and to seek an award of fees if litigation occurs.

Second, **the impact of Travelers may not be limited to contract-based fees, or to fees of creditors’ attorneys.** In *In re Busch*, 369 B.R. 614 (10th Cir. BAP 2007), one Bankruptcy Appellate Panel reasoned that where fees are awarded by state law, they come within *Travelers* also, and in *In re Hoopai*, 369 B.R. 506 (9th Cir. BAP 2007), another such panel reasoned that under *Travelers* a creditor may be liable for the debtor’s attorney fees where the right to fees is mutual and the debtor prevails.

Third, **the impact of Travelers may be broader than attorney fees.** For example, the 9th Circuit BAP says *Travelers* stands for the broad proposition that claims are presumed allowable – that it means “we must find a basis in section 502 to disallow a claim, and absent such basis, we must allow it”. In *In re Rodriguez*, 385 B.R. 535 (9th Cir. BAP 2007). That represents a radical change in bankruptcy thinking – if it is adopted by other courts.

<sup>1</sup> For example, the creditor may not wish to use the typical “prevailing party” clause on fee shifting. “[I]t is common for a creditor’s counsel to take a number of actions in a bankruptcy case for which there is no prevailing party. Counsel for creditors commonly attend hearings to monitor a bankruptcy case; participate on creditors’ committees; attend statutory meetings of creditors; prepare and file proofs of claim; review myriad notices and pleadings that may or may not affect their client’s claims; and render various other legal services unique to bankruptcy proceedings. In these types of actions, it is difficult, if not impossible, to prove that a creditor is a “prevailing party” that would allow recovery of legal fees.” Craig M. Rankin and Daniel H. Reiss, ‘*Travelers Cas.*’ Part II, NAT’L L.J. (Nov 5, 2007).

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