Client Alert

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Bankruptcy Court Disallows Secured Lender's Post-Petition Legal Fees for "Policing" Chapter 11 Case

On March 27, 2019, the United States Bankruptcy Court for the Northern District of West Virginia issued an opinion[1] holding that an over-secured creditor could not recover a portion of the creditor's attorney's fees incurred in connection with the borrower's bankruptcy proceeding despite provisions in the loan agreement that provided for recovery of attorney's fees "incurred in connection with the enforcement" of the loan documents. The opinion underscores the need for (i) careful drafting of loan documents for secured commercial loans to ensure that, in the event of a borrower bankruptcy filing, the provisions are broad enough to require the payment of the creditor's post-petition attorney fees and (ii) proper planning once the debtor files bankruptcy to ensure that all actions the secured creditor takes in the borrower's bankruptcy proceeding fall within the scope of the provisions for recovery of attorney's fees.

Background

The debtor, Emerald Grande, LLC, owns and leases commercial real estate in the Charleston, West Virginia area. Prior to filing for bankruptcy, the debtor obtained financing from Premier Bank ("Premier") through two construction loans secured by real estate being improved by the loan proceeds and the revenue generated by the property. The loans were documented by construction loan agreements, promissory notes and security instruments related thereto.

In January 2017, the debtor filed for relief under Chapter 11 of the Bankruptcy Code. Premier filed a proof of claim in the debtor's bankruptcy case asserting a secured claim for the balances due on its construction loans. As discussed in more detail below, Premier was actively involved in the case over that period of time, including challenging claims of other creditors and filing a motion to dismiss or convert the case to Chapter 7. Toward the conclusion of the case, Premier filed an amended claim asserting, among other amounts, $154,961.21 in accrued attorney's fees and expenses pursuant to the following terms of the suite of documents related to the loans:

- The construction loan agreements and commercial security agreements provide Premier's legal expenses "incurred in connection with the enforcement of this Agreement," may be paid by the debtor, and that such costs and expenses include those incurred "for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction)."

- The promissory notes permit Premier to "hire or pay someone else to help to collect [the notes] if [the debtor] does not pay," and that the debtor agrees to pay such fees, "including attorneys' fees, expenses for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction)."

- The credit line deeds of trust allow Premier to collect "costs and expenses of preserving and protecting [its collateral]," "costs and expenses paid or incurred to…enforce [its] security interests

[1] The decision is *In re Emerald Grande, LLC*, Case No. 17-00021, 2019 WL 1421429 (Bankr. N.D. W. Va. March 27, 2019).

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> and liens…or to defend any claims made or threatened against [it] arising out of the transactions contemplated hereby," "all reasonable expenses [it] incurs that in [its] opinion are necessary at any time for the protection of its interest or the enforcement of its rights," including "fees and expenses for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction)."

The debtor challenged Premier's request for attorney's fees and expenses pursuant to Section 502(b) of the Bankruptcy Code. Specifically, the debtor objected to the portion of Premier's fees related to Premier's: (1) challenge of an administrative claim asserted against the debtor by a third party; (2) monitoring of third party's own pending bankruptcy case; (3) attempts to seek dismissal or conversion of the debtor's bankruptcy case; and (4) clerical work.

Court's Decision

The debtor objected to these fees on the basis that they are not recoverable under the terms of the loan documents. The court agreed, determining that the fees were not "incurred in connection with the enforcement of" the various loan documents or "to help collect [Premier's claim against the debtor]." The court looked to the common example in the loan documents of a motion to modify the automatic stay as the type of action that could support an award of attorney's fees. But the court noted that "fees incurred for generally 'policing' a case do not, in the court's view, fall within the purview of enforcing loan documents."

Specifically, the court held that Premier's "generalized insecurity" concerning an administrative expense claim against the debtors, or the debtor's alleged lack of capital reserves, were insufficient to establish that the debtor's service of Premier's debt would be impacted by the allowance of the third party's administrative claim. Furthermore, the court ruled that pursuing a motion to dismiss or convert the debtor's bankruptcy case, monitoring the third party's bankruptcy case and performing "clerical work" were all unrelated to enforcement of Premier's loan documents. The court simply was not convinced that these actions would have improved Premier's position. Therefore, the court denied Premier's request to recover attorney's fees against the debtor in the four challenged categories,

Takeaways

The court's decision in *In re Emerald Grande, LLC* illustrates that an over-secured creditor cannot assume that all of its post-petition attorney's fees will be chargeable to the debtor's estate in a Chapter 11 case. A number of other bankruptcy courts have limited or disallowed over-secured creditors' attorney's fees for similar reasons. *See,* e.g., *In re BDC Capital, Inc.*, No. 11-15340-RGM, 2014 Bankr. LEXIS 2306, at *13-14 (Bankr. E.D. Va. May 24, 2014) (distinguishing between actions to collect pre-petition judgment and protect collateral); *In re Sundale, Ltd.*, 483 B.R. 23 (Bankr. S.D. Fla. 2012) (disallowing portion of over-secured creditor's attorney's fees on the basis that they were unreasonably excessive in proportion to value of collateral); *In re Kalian*, 178 B.R. 308 (Bankr. D.R.I. 1995) (noting that an over-secured creditor's fees will be reduced when the court is unable to ascertain the nature of the services provided, when it is unclear that the fees were incurred in the collection of the obligation in question or when the hours incurred are not provided).

At the outset of the lending relationship, a secured creditor should make sure that the language in the loan documents concerning recovering attorney's fees is appropriately drafted to provide the secured creditor with the best possible argument for recovering post-petition attorney fees. In the *Emerald Grande* case, the court read the related provision to be limited to actions to enforce the loan agreement and protect the collateral, including based on the repeated reference to a motion to modify the automatic stay as an example of a covered enforcement action. Secured creditors may benefit from avoiding such limitations in their loan documents. Further, the applicable provisions in the loan documents generally should provide for recovery of attorney's fees not only for protecting the collateral and enforcing the loan documents, but also for filing and defending claims in bankruptcy, challenges to the secured creditor's liens and any other actions that may relate to a borrower's bankruptcy filing.

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Finally, even with appropriate attorney's fee language in the loan documents, secured creditors should be cautioned not to assume that their attorney's fees and costs will be payable by the debtor's estate. Prior to taking action in a borrower's bankruptcy case, a secured creditor should review the applicable language in the loan documents to understand whether acts that it intends to take in the bankruptcy case are within the scope of the attorney fee and cost reimbursement provision. A key question for the court in the *Emerald Grande* case was whether the actions taken by Premier would have improved its position. Secured creditors should consider the same question before authorizing counsel to take action in a borrower's bankruptcy case, particularly if the action could be viewed as "policing" rather than "enforcing or protecting" the secured creditor's claim or rights in collateral.

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