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Recent Decision on Attorneys' Fees in Bankruptcy Highlights Issue Left Unresolved by Supreme Court

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A district court recently held that section 506(b) of the Bankruptcy Code does not permit an unsecured creditor to collect attorneys' fees incurred during bankruptcy, even where the parties' contract entitled the creditor to recover such fees. This decision in the A.P. Green case highlights a still-unresolved issue of unsecured and undersecured creditors' rights to recover attorneys' fees following the Supreme Court's decision in the *Travelers* case earlier this year. This issue may be of substantial practical importance to financial institutions and others that serve as indenture trustees, in cases in which the issuer of the underlying securities files for bankruptcy.

District Court Disallows Unsecured Claim Under § 506(b)

In *J.P. Morgan Trust Co. v. A.P. Green Industries, Inc.,* No. 06-0885 (W.D. Pa. 2007), J.P. Morgan Trust filed a claim for attorneys' fees and costs incurred during A.P. Green's bankruptcy case--fees and costs to which J.P. Morgan was entitled by contract. The debtor objected, relying on section 506(b) of the Bankruptcy Code, which provides: "To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose."

Though section 506(b) expressly applies only to secured creditors' claims, the district court relied on section 506(b) to affirm the bankruptcy court's rejection of J.P. Morgan's claim for the fees in its unsecured claim. Citing the maxim "*expressio unius est exclusion alterius*" (the expression of one is the exclusion of the alternatives), the district court concluded that section 506(b)'s silence as to undersecured claims for attorneys' fees indicated that they were excluded from payment. Section 506(b) permits only the secured creditor to collect fees and expenses provided for by contract from his security cushion. "[I]t 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*. In other words, an undersecured creditor does not have an unsecured claim for attorneys' fees under section 506(b).

The court rejected J.P. Morgan's argument that the claim for fees should be allowed under section 502(a), without reference to 506(b), stating that such an interpretation of the Code "would provide

the holder of an unsecured claim for contractual attorneys' fees and costs with more rights than the holder of an undersecured claim for these same amounts," a result the court surmised was contrary to Congress's intent. *Id*. Lastly, the district court found that allowance of such fees would violate the "spirit of the Code" since the accrual of fees and costs against an 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*.

As the A.P. Green court noted, there is no Third Circuit or Supreme Court precedent on the issue, and the courts are split as to whether 506(b) permits unsecured creditors to recover attorneys' fees incurred during bankruptcy cases. The A.P. Green court sided with those courts that have concluded that 506(b) applies only to oversecured creditors.[i] Other courts, including two courts of appeals, have insisted that the section leaves unsecured creditors' post-petition rights unaffected.[ii]

No Clear Direction from Supreme Court

Earlier this year, in *Travelers Casualty and Surety Co. of America v. Pacific Gas and Electric*, 549 U.S. __ (2007), the Supreme Court declined to resolve the split on 506(b)'s application to unsecured creditors because the issue was not properly before the Court. In Travelers, the Supreme Court invalidated the Ninth Circuit's so-called Fobian rule, under which creditors were barred from asserting a claim for attorneys' fees if those fees related to litigating questions of bankruptcy law. *Fobian v. Western Farm Credit Bank,* 951 F.2d 1149 (9th Cir. 1991). Emphasizing that the American Rule--that each party pays its own attorneys' fees--may be overcome by contract or statute, the Court concluded that the Code does not provide for the disallowance of a claim for such fees simply because bankruptcy issues were litigated. Rather, the Court explained, the question of claims allowance under Section 502 of the Bankruptcy Code generally provides that the claim should simply be determined in accordance with otherwise applicable nonbankruptcy law. Courts should "generally presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed."

While it did not defend the *Fobian* rule on its own terms, PG&E argued in the Supreme Court that Travelers' claim for contractual attorneys' fees should nevertheless be disallowed based on the same reasoning (the negative inference from Section 506(b)) that the court in A.P. Green adopted. Because that rationale had not been presented or considered below, the Supreme Court declined to consider it. At argument, however, Justice Kennedy, at least, expressed some skepticism about that result, commenting that he believed the negative inference "is misplaced in this context."

The Bottom Line

The Supreme Court clarified one issue regarding unsecured creditors' claims for attorneys' fees in its *Travelers* decision, but the A.P. *Green* decision in the Western Pennsylvania district court demonstrates that another aspect of these claims remains in dispute. Unless and until the Supreme Court does address the section 506(b) issue, unsecured and undersecured creditors' rights to recover attorneys' fees incurred during bankruptcy may depend upon the jurisdiction of the bankruptcy case and the bankruptcy judge's interpretation of bankruptcy law and policy.

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[i] See In *re Miller*, 344 B.R. 769, 773 (Bankr. W.D.Va. 2006); *Ins. Co. of N. Am. v. Sullivan*, 333 B.R. 55, 61 (D. Md. 2005); *In re Global Indus. Techs., Inc*., 327 B.R. 230, 239 (Bankr. W.D. Pa. 2005); In *re Hedged-Investments Assocs., Inc*., 293 B.R. 523, 525-26 (D. Col. 2003); *In re Southeast Banking Corp*., 188 B.R. 452, 462 (Bankr. S.D. Fla. 1995); *In re Woodmere Investors Ltd. P'ship*, 178 B.R. 346, 356 (Bankr. S.D.N.Y. 1995).

[ii] See In *re Welzel*, 275 F.3d 1308, 1319 (11th Cir. 2001); In *re United Merchants & Mfrs., Inc*., 674 F.2d 134, 138 (2d Cir. 1982); *Liberty Nat. Bank & Trust Co. of Louisville v. George*, 70 B.R. 312, 317 (W.D. Ky. 1987); *In re New Power Co*., 313 B.R. 496, 510 (Bankr. N.D. Ga. 2004); *In re Byrd*, 192 B.R. 917, 919 (Bankr. E.D. Tenn. 1996).

Authors

George W. Shuster Jr.

PARTNER

george.shuster@wilmerhale.com

+1 212 937 7232