

# Is it Time to Re-Write Your Attorney's Fees Provision?

Written By **Lance P. Martin** (lpm@wardandsmith.com)

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**Bankruptcy court is not the first place that comes to mind when a lender thinks about full recovery on a loan.**

Usually, debtors file bankruptcy because they can't pay all their creditors in the ordinary course of business. But even without enough assets or revenue to go around, lenders nevertheless can take pro-active steps to maximize their recovery when a borrower seeks bankruptcy protection.

Indeed, sometimes recovery may extend beyond a loan's principal and interest to attorney's fees. And the way to be in the best position to recover some or all of your attorney's fees is with a well-drafted attorney's fees provision that obligates your borrower to pay for the specific things your attorney will do in bankruptcy court. If your loan documents contain a generic provision that obligates your borrower to pay legal fees "incurred in connection with enforcement or collection of this obligation," now may be the time to update them.

## Secured Claims in Bankruptcy

In bankruptcy, creditors are generally classified as having either a "secured" or "unsecured" claim. A secured claim is supported by the value of collateral securing repayment of the claim, while an unsecured claim is not supported by collateral. An unsecured claim is combined with the unsecured claims of other creditors, and often a percentage of the total is repaid pro rata.

Section 506(b) of the Bankruptcy Code provides that if a creditor has an over-secured claim (i.e., the value of the creditor's collateral exceeds the loan balance on the date the debtor filed bankruptcy), then the creditor is allowed a claim for post-petition interest and any reasonable fees, costs, or charges provided under the loan documents. The collateral value sets the ceiling on the recovery of post-petition interest and fees. In other words, if your collateral is worth \$1,000,000 and your debt was \$750,000 when your borrower filed bankruptcy, then you have \$250,000 available to cover post-petition interest and attorney's fees.

## Under-Secured and Unsecured Claims in Bankruptcy

Having an over-secured claim is the best way to recover a debt. But even if you have an under-secured claim (i.e., the collateral is worth less than the debt) or an unsecured claim (i.e., no collateral), you still may claim your legal fees. In bankruptcy courts in North Carolina, if a lender's loan documents contain an attorney's

fees provision, then the lender may file a claim for post-petition fees incurred during the bankruptcy – regardless of if the claim is over-secured, under-secured, or unsecured. The claim should be treated like the other unsecured claims and, if the estate has assets, paid pro rata.

## **'Reasonable' Legal Fees in Bankruptcy**

In North Carolina, a lender's right to recover legal fees depends on its loan documents. If your loan agreement or promissory note allows recovery for legal fees, then you can recover them if you comply with certain statutory requirements. Outside of bankruptcy, recovery is set at 15% of the debt when you sue your borrower. In bankruptcy, however, the court will not automatically reward you 15%. The bankruptcy court will consider the reasonableness of your legal fees and, to determine that, will examine the scope of your attorney's fees clause. Most standard loan documents have an attorney's fees clause, but it may not cover all the legal activity in a bankruptcy case.

In In re Emerald Grande, LLC, a bankruptcy judge in West Virginia recently resolved a dispute over the scope of an attorney's fees clause. In that case, the over-secured creditor's loan documents allowed recovery for fees “incurred in connection with the enforcement of this Agreement,” and included expenses incurred “for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction).” Siding with the debtor, the court held that fees associated with the creditor's opposition to an administrative expense claim, monitoring the bankruptcy case, seeking the conversion or dismissal of the case, and other clerical work incidental to its participation, in this case, were not covered by the loan documents. The court held they were not “incurred in connection with the enforcement of” the loan. The court explained its reasoning this way: “At bottom, simply participating as a creditor in a bankruptcy case does not translate, at least in the court’s view, to enforcing loan documents or collecting against the Debtor. Rather, the nature and substance of its participation is the crucial focus. Here, that focus does not center on the enforcement of the loan documents or collection.”

North Carolina bankruptcy courts are not bound to follow the Emerald Grande decision. But it exemplifies how courts will analyze these disputes. The creditor in Emerald Grande may have fared better with a more sweeping attorney's fees provision that covered their actions in the bankruptcy. Bankruptcy cases -- particularly commercial cases brought under Chapter 11 -- can last years and often require a multitude of activity by lender's counsel. This includes first day orders, cash collateral issues, executory contract, and unexpired leases, post-petition financing, monthly operating reports, and multiple iterations of disclosure statements and plans of reorganization. Some of these matters may not affect you directly but, in the grand scheme, implicate your ultimate recovery.

Unfortunately, analyzing and responding to these matters may not – in the mind of a bankruptcy judge – be directly related to collection or enforcement of the debt. So it would be wise for lenders to endeavor to cover as much of that activity as possible in their attorney's fees provision. Importantly, lenders can bolster this provision not only in original loan documents, but also in modification, extension, and forbearance agreements. Again, it is no guarantee you will recover your legal fees, but it's an easy way to improve your chances.

If you need assistance with drafting a new attorney's fees provision for your loan and workout documents, please contact our experienced Creditors' Rights attorneys.

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Lance P. Martin.

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