Cullen | Dykman

Secured or Not: There's No Carte Blanche on Attorney's Fees

March 12, 2024

A recent decision by a Colorado Bankruptcy Court (the "Court") reminds parties that Section 506(b) of the Bankruptcy Code (the "Code") is not a blank check for oversecured lenders and their counsel to incur legal fees and charge them to the borrower-debtor. Focusing on the plain language of the statute, the Court reviewed the lender's claim for legal fees incurred before and during the bankruptcy for reasonableness and disallowed more than half its claim for legal fees and expenses. In finding these fees unreasonable, the Court noted that it was the responsibility of the law firm and the lender to exercise judgment to ensure that the legal fees were reasonably incurred.

Section 506(b) of the Code permits secured lenders to recover, in addition to the prepetition amount of the claim, "interest on such claim, and any **reasonable** fees, costs, or charges provided for under the agreement under which such claim arose" to the extent of the value of the collateral. 11 U.S.C. § 506(b)(emphasis added). *See also United States v. Ron Pair Enter*s., 109 S. Ct. 1026 (1989)("Recovery of post-petition interest is unqualified, whereas recovery of those fees, costs, and charges is allowed only if they are reasonable and provided for in the agreement under which the claim arose.").[1] In *In re Sirios*, 20-16709 (Bankr. D. Colo. Jan. 5, 2024), the Court addressed the reasonableness of legal fees and expenses asserted by the lender in its proofs of claim. In total, the lender sought legal fees and expenses totaling more than $160,000. The Court ultimately allowed only a little more than $70,000 in legal fees and expenses following a detailed analysis of the legal fees and expenses incurred.

At the outset, the Court noted that there was no question that the secured lender was oversecured, that the borrower's agreement provided that the lender's reasonable expenses, including fees, would be paid by the borrower and that Code section 506, permitted enforcement of that provision. *In re Sirios*, 20-16709 [Dkt. No. 262], pp. 4-5 (Bankr. D. Colo. Jan. 5, 2024). The underlying question in this case was a matter of reasonableness. Addressing that, the Court made three inquiries: (a) were the services rendered necessary, (b) was the time required appropriate, and (c) was there value gained from those services. While the Court's analysis is based on the circumstances of that case, the Court's opinion provides useful guidance to lenders and their counsel, as well as a debtor objecting to the claims of lenders.

First of all, section 506 does not provide a carte blanche to secured lenders to recover the expenses and fees associated with enforcement of their agreement with the borrower. They have a responsibility to monitor their costs and incur expenses in a reasonable manner. The Court noted that the law firm had not prevented

duplication or discounted to eliminate it and had "aggressively pursued matters that had a low likelihood of success and did not discount the fees incurred to reflect the ultimate lack of success and lack of benefit to either the bankruptcy estate or the Bank." *Id*. at p. 6. The Court also criticized the lender for its failure to review these bills and suggested that the lender employ a level of oversight that it would in cases where it was paying the legal fees. *Id*.

Secondly, counsel for secured lenders should anticipate the possibility that a court will review fee statements and be clear in descriptions of work performed and avoid block billing. For bankruptcy practitioners, it is a best practice to treat time entries as if the work were being performed for a debtor or official committee of unsecured creditors, and for non-bankruptcy professionals to consult a bankruptcy colleague as to how to bill in a manner that is sufficiently detailed but avoids the need for redaction of matters that may be subject to attorney client privilege.

Thirdly, the opinion reminds us of the need to avoid duplication. And where duplication is necessary, to apply some reduction formula that recognizes the duplication and allows for some compensation, but hopefully avoids the double charge assertion.

The question that now remains is what will the court consider when reviewing whether the legal fees and expenses sought by a lender are reasonable and permissible under section 506(b) of the Code?

Courts in the Second and Seventh Circuits have relied on specific factors to determine the reasonableness of fees under 506(b). These factors include:

1. The legal services must be authorized by the loan agreement;
2. They must be necessary to the promotion of the client's interests;
3. They must be permitted under applicable law, including the Bankruptcy Code;
4. They must be compatible with bankruptcy policy as derived from relevant provisions of the Bankruptcy Code and the judicial decisions which construe it;
5. The time spent must be appropriate to the complexity of the task;
6. The hourly rate must be appropriate under applicable standards;
7. The tasks must have been assigned to fewest and least senior attorneys able to render the services in a competent and efficient manner;
8. The fee should be adjusted to reflect duplicative services rendered by attorneys representing other parties with a common interest in the case; and
9. The fee should be adjusted to reflect the court's observation of the nature of the case and the manner of its administration.

In re Canal Asphalt, Inc., 2017 Bankr. LEXIS 1289 *19 (Bankr. S.D.N.Y. 2017), citing *In re Wonder Corp. of America*, 72 B.R. 580, 589 (Bankr. D. Conn. 1987); *aff'd In re Wonder Corp. of America*, 82 B.R. 186 (D. Conn. 1988); *see also In re Mid-State Fertilizer Co.*, 83 B.R. 555 (Bankr. Southern Dist. Ill. 1988).

Finally, Professional Rules of ethics may provide guidance as well. In *Sirios*, Judge Tyson referred to the Colorado Rules of Professional Conduct, where she explains that after the Court has determined a reasonable attorney fee

amount, "[the Court] may adjust the amount based on the factors outlined in Rule 1.5 of the Colorado Rules of Professional Conduct. . . ." *Sirios*, p. 6.

These standards can be used as valuable guidance for attorneys when entering time and preparing bills for secured lender clients whose borrowers are in bankruptcy or where bankruptcy may be likely.

Please note this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and the recipient. If you have any questions regarding the provisions discussed above, or any other aspect of bankruptcy law, please contact Michael H. Traison (mtraison@cullenllp.com) at 312.860.4230 or Michelle McMahon (mmcmahon@cullenllp.com) at 212.510.2296.

Thank you to Kelly McNamee, a Law Clerk pending New York bar admission, who assisted in the preparation of this alert.

This Client Alert is dedicated to our professional colleague, friend and fellow ABI Member George Kelakos. May his memory be for a blessing.

Footnotes

[1] Michael Traison, one of the article's authors, second chaired this argument before the Supreme Court on Halloween day 1988.

Practices

- Bankruptcy and Creditors' Rights

Attorneys

- Michelle McMahon
- Michael H. Traison
- Kelly McNamee