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IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

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IN RE: LOVERIDGE MACHINE AND TOOL CO., INC., Debtor.	Bankruptcy No. 83C-00071
IN RE: DENNIS T. AND MARSHA A. LOVERIDGE, Debtors.	Bankruptcy No. 83C-00315
IN RE: RALPH S. AND BETTY T. LOVERIDGE, Debtors.	Bankruptcy No. 83C-00313
IN RE: KENT H. AND VICKY A. LOVERIDGE, Debtors.	Bankruptcy No. 83C-00312
IN RE: RALPH DALE AND LINDA LOVERIDGE, Debtors.	Bankruptcy No. 83C-00238

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MEMORANDUM OPINION AND ORDER
DENYING ATTORNEYS' FEES AND COSTS

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APPEARANCES: Glen E. Davies of WATKISS & CAMPBELL, Salt Lake City, Utah for Northwest Acceptance Corporation.

Rulon T. Burton of BURTON & SCHEISS, Salt Lake City, Utah, for the debtor.

The issue before the Court is whether Northwest Acceptance Corporation ("Northwest"), an oversecured creditor of Loveridge Machine and Tool Co., Inc., the above debtor, is entitled to an allowance of attorneys' fees and costs under section 506 (b) of the Bankruptcy Code, 11 U.S.C. §506 (b). I conclude that it is not.

FACTUAL AND PROCEDURAL BACKGROUND

On January 10, 1983, Loveridge Machine and Tool Company, Inc. filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. On June 22, 1983, the Court entered an order consolidating the case with those of the individual debtors for administrative purposes. The debtors' Third Amended Plan of Reorganization as Modified was confirmed by order of the Court dated February 26, 1984.[1]

The secured obligation of the debtor to Northwest arises under the terms of a loan security agreement granting Northwest a security interest in accounts receivable, inventory, equipment

1 The facts and background of this case are discussed in relation to the allowance of interest rates under 11 U.S.C. §506 (b) in In Re Loveridge Machine & Tool Co., Inc., 36 B.R. 159 (Bkrtcy. D. Utah 1983).

and fixtures.[2] While all parties agree that Northwest holds an allowed secured claim secured by property the value of which is greater that its claim, the security agreement has never been made a part of its claim or the record in this case.[3] In connection with the bankruptcy case, attorneys for Northwest expended a total of 182.4 hours for which they seek an allowance

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2 See Debtor's Third Amended Chapter 11 Plan as Modified, Article IV at §4.04; Amended Proof of Claim of Northwest Acceptance Corporation (Nov. 12, 1983).

3 At the hearing on confirmation, Glen E. Davies, the attorney representing Northwest, read a stipulation into the record respecting the secured claim of Northwest and the allowance of attorneys' fees and costs thereunder:

> Mr. Davies: Your Honor, we have reached, after negotiations with counsel for the debtors, an agreement with respect to the treatment of Northwest Acceptance Corporation under the plans of reorganization as follows which makes the following changes in the plans as submitted to the Court: Northwest will be paid its allowed secured claim, which allowed secured claim will include the allowance for reasonable attorney's fees and costs of Northwest Acceptance Corporation through the date of confirmation. We will supply a proof of claim with respect to those fees to Mr. Burton, who can then review them. And if he has any problems with them, we can resolve the amount of that before the Court at the subsequent time. But it has been stipulated that the allowance for attorney's fees and costs include through the date of confirmation.

Transcript of hearing at 8 (Sept. 1, 1983).

On November 12, 1983, Northwest filed an "Amended Proof of Claim Regarding Attorneys' Fees," which claimed the sum of $15,957.33 as "Attorneys' fees and collection costs as allowed under §506(b)." A copy of the writing upon which the claim is based was not attached to the claim; instead, the following was typed on the claim form: "Copies of the Loan Security Agreement have already been supplied [sic] the Court. The affidavit of counsel for Northwest Acceptance Corp. supporting the amount of attorney's fees and collection costs is attached." Contrary to Northwest's assertion, the record in the case does not contain the security agreement upon which its section 506(b) claim arises.

of $15,644 in fees and $313.53 in costs. The debtor has raised several legal arguments for disallowance of the attorneys' fees sought by Northwest. Generally, those arguments go to the adequacy of the detail and itemization of the application, and to the reasonableness of the fees.

A hearing was held on April 25, 1984, on the debtor's objection to Northwest's claim for attorneys' fees, at which time the Court denied all compensation and costs to Northwest.[4] This memorandum opinion elaborates the basis for the Court's ruling.

DISCUSSION

It is acknowledged by all parties that Northwest Acceptance Corporation is an oversecured creditor. Pursuant to Section 506(b), the holder of an oversecured claim is entitled to recover out of the collateral postpetition interest, reasonable fees,

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4 While the Court expressed its concern that the services of Northwest's attorneys conferred no benefit to the debtor's estate, it recognizes that a secured creditor's right to attorney's fees under section 506(b) arises under and is governed by the terms of the security instrument itself. See In Re Virginia Foundry Co., Inc., 9 B.R. 493 (W.D. Va. 1981); In Re Neil Properties,Inc., 360 F.Supp. 914 (S.D.Cal. 1966). Since the estate received no benefit from Northwest's litigation, which consisted primarily of objecting to its treatment under the debtor's plan of reorganization, the administrative claim cannot be allowed as an expense which was necessary for the preservation of the estate under Section 503(b)(1)(A). Cf. In re Richton International Corp., 15 B.R. 854 (Bkrtcy. S.D.N.Y. 1981).

charges and costs as provided for in the security agreement that is the basis of the claim.[5] Therefore, it is entitled to reasonable attorneys' fees and reimbursement of expenses provided that it can satisfy the other requirements of Section 506(b), which limit the allowance to "any reasonable fees, costs or charges provided under the agreement under which the claim arose."[6] This requires the court to make a two-fold inquiry into (1) the terms of "the agreement under which the claim arose," and (2) the reasonableness of the fees claimed. Matter of Kennedy Mortgage Co., 23 B.R. 466, 469, 9 B.C.D. 805 (Bkrtcy. D. N.J. 1982); In re Hart Ski Mfg. Co., Inc. 9 B.R. 397, 399 (Bkrtcy. D. Minn. 1981).

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5 Section 506(b) provides:

> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, 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 under the agreement under which such claim arose.

6 The legislative history indicates that Section 506(b) was intended to codify current law by entitling an oversecured creditor to recover interest, costs, charges or attorneys' fees as provided in the agreement under which the claim arose. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 356-57 (1977), 1978 U.S. Code Cong. & Admin. News, p.6312; S. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978), 1978 U.S. Code Cong. & Admin. New, p.5854; 124 Cong. Rec. H11095 (daily ed. Sept. 28, 1978) (remarks of Representative Edwards); 124 Cong. Rec. S17411 (daily ed. Oct. 6, 1978) (remarks of Senator DeConcini).

1. The Treatment of Statutory Attorneys' Fees Under 11 U.S.C. §506(b)

The Court begins with the proposition that a litigant must bear the costs of his attorney's services in the absence of a statute or an enforceable contract providing therefor. Ruckelshaus v. Sierra Club, ___U.S.___, 103 S. Ct. 3274, (1983); Summit Valley Industries, Inc. v. Local 112, United Brotherhood of Carpenters, 456 U.S. 717, 102 S. Ct. 2112, 72 L. Ed. 2d 511 (1982); Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240, 95 S. Ct. 1612, 44 L. Ed. 2d 141 (1975); F.D. Rich Co. v. Industrial Lumber Co., 417 U.S. 116, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974); Hall v. Cole, 412 U.S. 1, 93 S. Ct. 1943, 36 L. Ed. 2d 702 (1973). Likewise, attorney's fees are generally not recoverable in bankruptcy cases and proceedings in the asence of an express statutory provision. In re Fox, 725 F.2d 661 (11th Cir. 1984). This is the traditional or "American" Rule. Statutes in derogation of this traditional principle of law must be strictly construed. As a prerequisite to recovery of attorneys' fees under Section 506(b), the creditor's underlying security agreement must expressly provide for the allowance of attorneys' fees and costs incurred in collecting, or pursuing the claim.

Matter of Astro-Netics, Inc., 28 B.R. 612, 614 (Bkrtcy, E.D. Mich. 1983).[7]

In numerous cases under the Bankruptcy Code, courts have denied attorneys' fees and costs under Section 506(b) where such expenses were beyond the scope of the underlying security instrument. In In Re Trombley, 31 B.R. 386, 10 B.C.D. 1081 (Bkrtcy. D. Vt. 1983), the oversecured creditor sought to recover attorneys' fees under Section 506 (b) pursuant to a promissory note which gave the holder a right to collect reasonable attorneys' fees if suit was brought to collect the note. The court strictly construed the attorneys' fees clause and disallowed all compensation because a lawsuit was not actually instituted. "In the instant case the entitlement to an attorney's fee was restricted to the actual institution of a suit. Since none was brought there is no justification for allowing its attorney's fees." Id. at 388.

In In Re Dawson, 32 B.R. 179 (Bkrtcy. W.D. Mo. 1983), attorneys for the Mark Twain Bank, an oversecured creditor, sought an allowance of fees and reimbursement of expenses under Section 506(b). The various notes and security instruments under which the secured claim arose provided that the debtor was

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[7] For a discussion of the similar treatment afforded to attorneys' fees clauses under the former Bankruptcy Act, see 3A COLLIER ON BANKRUPTCY 63.15[3] (14th ed. 1975).

obligated to pay "reasonable attorney's fees" if referral to an attorney for collection was necessary. In examining the services performed by the bank's attorneys, the court disallowed fees for services that were not strictly within the terms of the security instruments, viz., those reasonably related to collection of the debt. Likewise, in Matter of Scarboro, 7 B.R. 609 (Bkrtcy. M.D. Ga. 1980), modified, 13 B.R. 439 (M.D. Ga. 1981), the court examined the secured creditor's contract with the debtor for the purpose of determining its allowance of attorneys' fees under Section 506(b). While the agreement contained an attorneys' fees clause, that provision did not expressly mention costs of litigation. Accordingly, the Court disallowed the costs of filing fees, travel expenses, photocopy costs, court reporter fees and the like.

In In Re Roberts, 20 B.R. 914, 6 C.B.C. 2d 892 (Bkrtcy. E.D.N.Y. 1982), the court held that for purposes of allowance under Section 506(b), attorneys' fees clauses in security agreements are to be strictly construed against the secured creditor. In Roberts, the Chapter 13 debtors objected to the claim filed by Ninth Federal Savings and Loan Association, a secured creditor holding a mortgage on the debtor's principal residence, insofar as attorneys' fees were to be allowed. The court noted that Section 506(b) is in derogation of the American Rule requiring each party in litigation to bear the costs of its

own attorneys. The court held that in order to be compensable from the debtors' estate the services performed must fall squarely within the language of the mortgage. The court found that the provision of the mortgage allowing attorneys' fees was merely intended "to ensure reimbursement of any outlays for taxes, water rates, or any obligations payable by the mortgagee under the mortgage, rather than to recover attorneys' fees in foreclosure or bankruptcy proceedings." Id. at 921. Consequently, attorneys' fees were not allowed to the oversecured creditor under Section 506(b).

In Matter of Kennedy Mortgage Co., 23 B.R. 466, 9 B.C.D. 805 (Bkrtcy. D.N.J. 1982), the Bank of New Jersey sought to recover post-petition attorneys' fees in connection with various promissory notes and mortgages with the debtor. The court found that since the language in the promissory notes pertaining to attorneys' fees did not clearly apply to all collection costs incurred, no attorneys' fees were recoverable under Section 506(b).

> Even though the notes signed by the debtor provided that the Bank would be reimbursed for its attorneys' fees, such a contractual provision is not a carte blanche for the Bank to charge the debtor any fee incurred, regardless of the nature and difficulty of the work performed. This is in accordance with the general American Rule that attorneys' fees are not ordinarily recoverable in the absence of a statute or

enforceable contract providing therefore [sic].

Id. at 473-74.

The foregoing cases illustrate the principle that exceptions to the American Rule, whether statutory or contractual, will be strictly construed. In bankruptcy cases, the judicial responsiblity to make an independant determination of the appropriateness of compensation to be paid from funds of the estate mandates careful scrutiny of all Section 506(b) claims.

2. Effect of Secured Creditor's Failure to File Security Agreement with Proof of Claim

The basis upon which Northwest asserts a right to recover attorneys' fees and costs is that its agreement with the debtor so provides. However, that agreement has never been made a part of the record of this case.

At the September 1, 1983, confirmation hearing the parties stipulated that Northwest could file a proof of claim with repect to attorneys' fees claimed under Section 506(b).[8] Thereafter, a proof of claim was filed. However, it was not accompanied by a

[8] See note 3, *supra*.

copy of the security agreement.[9] Bankruptcy Rule 3001[10] mandates that the writing evidencing a secured claim be filed together with the proof of claim form. Rule 3001 continues the requirement under former Rule 302(c)[11] that any written security agreement accompany the proof of claim filed with the Court.

It is fundamental bankruptcy law that one who invokes the aid of the bankruptcy court by filing a proof of claim must abide by the consequences of the procedure. Gardner v. New Jersey, 329 U.S. 565, 573, 67 S. Ct. 467, 91 L. Ed. 504 (1947). Here, the

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[9] Id.

[10] Rule 3001(c) provides:

> Claim based on a Writing. When a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim. If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim.

[11] Rule 302(c) provided:

> Claim founded on a Writing.--When a claim, or an interest in property of the bankrupt securing the claim, is founded on a writing, the original or a duplicate shall be filed with the proof of claim unless the writing has been lost or destroyed. If lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim. If a security interest in property of the bankrupt is claimed, the proof of claim shall be accompanied by satisfactory evidence that the security interest has been perfected.

See generally 12 COLLIER ON BANKRUPTCY ¶302.06, at 3-26 (14th ed. 1978).

oversecured creditor has disregarded the requirement that the security instrument accompany its proof of claim.

At the hearing on the debtor's objection to Northwest's claim for attorneys' fees and costs, Northwest had an additional opportunity to supplement the record or seek leave to amend its proof of claim to attach copies of the agreement evidencing the claim and the attorneys' fees provisions. However, Northwest did not submit any additional documentation, thus leaving the Court no basis upon which to make a Section 506(b) determination. In short, this Court cannot determine that the security agreement would have permitted attorneys' fees for the services performed in this case.[12]

In bankruptcy cases, the claim filing statute is to be strictly construed. In re Northern Steel Corporation, 137 F.

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[12] Other courts have shown no reluctance in closely examining claims for attorneys' fees under Section 506(b). For example, in In re Masnorth Corp., 11 B.C.D. 782 (Bkrtcy. N.D. Ga. 1984), the debtor's sole secured creditor, Midland Mutual Life Insurance Company, sought an allowance of $37,925 in attorneys' fees pursuant to Section 506(b) and in accordance with the security agreement of the parties. Midland held a mortgage on the debtor's real property. The mortgage was in default at the time the debtor filed its Chapter 11 petition. Under its Plan of Reorganization the debtor proposed to cure and reinstate the mortgage pursuant to 11 U.S.C. Section 1124. The fees were incurred in seeking relief from the automatic stay and objecting to confirmation of the Debtor's Plan of Reorganization. The bankruptcy court found that "the pervasive reason for Midland's objection to Masnorth's proposed cure and reinstatement was Midland's dissatisfaction with the 9 1/2% interest rate on the loan to Masnorth." Id. at 784.

Supp. 710, 711 (N.D. Ohio 1956). This requirement serves the underlying bankruptcy policy of efficient and economical case administration. In bankruptcy, even more than in other court practice, there is a manifest intent that matters move rapidly. In order to facilitate this objective there must necessarily be adherence to orderly procedural requirements.

The court has a duty to preserve whatever equity the debtor may have in property, both to facilitate reorganization and to protect the rights of all creditors in such a fund. See In re Garrett, 203 F.Supp 459 (N.D. Ala. 1962). By imposing stringent requirements upon oversecured creditors that seek attorneys' fees under Section 506(b), the court does justice to all parties.

In making its fee award decision, the court focused on Midland's motivation for raising its objections to the procedure and reinstatement of the debtor's mortgage obligations:

> Assuming that Mr. Walsh's testimony is accurate that reliance upon the attorney's fees clause was not a motivating factor, and assuming that the issue of statutory attorney's fees was only a minor concern, would a reasonable creditor have spent $38,000 of its own money to "protect" its $450,000 stake in real property with an admitted equity cushion in excess of $100,000? This Court answers that question in the negative. As to the surplusage, Midland must bear its own attorney's fees and expenses.

Id. at 782-83.

The court limited Midland to fees in the amount of $15,000, which the court found to be the amount "reasonably incurred to protect Midland's interest in light of Masnorth's decision to file bankruptcy and the preclusion of Midland's right to accelerate the debt and foreclosure under state law." Id. at 785.

The court is mindful that in passing on the allowance of claims it sits as a court of equity. Pepper v. Litton, 308 U.S. 295, 60 S. Ct. 238, 84 L. Ed. 281 (1939). The court is also aware that it possesses the equitable discretion to allow further amendment of the claim to permit compliance with Rule 3001(c). After a careful review of this case and with due consideration to the policies underlying the American Rule governing attorneys' fees, the requirements of Section 506(b) and Rule 3001(c) and counsel's failure to offer Northwest's security agreement into evidence in support of the claim, the equities of this case are such that the court is compelled to disallow Northwest's claim insofar as it includes attorneys' fees and costs incident to this chapter 11 case.[13]

CONCLUSION

An attorney for a creditor who opposes a plan of reorganization is ordinarily not entitled to payment for his services out of the estate, but must look to his own client for compensation. In a Chapter 11 case, the estate's obligation to

[13] In deciding this case with reference to the agreement under which Northwest's claim arose, the court finds it unnecessary to reach the question of the reasonableness of the fees claimed. The court notes, however, that the debtor's objections to Northwest's time records appear to have merit in view of the guidelines recently promulgated by the Tenth Circuit for determining if attorneys' fees are reasonable. See Ramos v. Lamm, 713 F.2d 546 (10th Cir. 1983).

pay attorneys' fees to an oversecured creditor under Section 506(b) does not arise until there has been full compliance with the conditions precedent stated in the Bankruptcy Code and the Bankruptcy Rules. No justification exists here for allowing Northwest to recover attorneys' fees. Northwest has had ample opportunity to supplement its Proof of Claim to include the underlying security agreement, but has declined to do so. Where an oversecured creditor's actions confer no benefit to the debtor's estate or its creditors generally and attorneys' fees and costs are sought to be paid from assets of the estate at the expense of other creditors, this Court will insist upon strict compliance with provisions of the Code and Rules.

In order to make an award under Section 506(b), the court must determine that the attorneys' fees sought to be charged to the debtor's estate are provided for in the agreement under which the debt arose. Since the security instrument is not part of the record, the application for attorneys' fees must be disallowed under Section 506(b). The attorneys' fees in question were not an expense necessary to the preservation of the estate and, therefore, are not allowable under Section 503(b)(1)(A).

IT IS, ACCORDINGLY, ORDERED that Northwest's claim for attorneys' fees and costs be disallowed in its entirety.

DATED this 18th day of July, 1984.

BY THE COURT:

Harold L. Mai

HAROLD L. MAI
VISITING U.S. BANKRUPTCY JUDGE