

Post-Bankruptcy Legal Fees

Second Circuit Joins Ninth Circuit in Allowing Fees Based on Pre-Bankruptcy Agreement

By Michael L. Cook

The United States Court of Appeals for the Second Circuit held on Nov. 5, 2009, that a creditor was entitled to its post-bankruptcy legal fees incurred under a pre-bankruptcy indemnity agreement. *Ogle v. Fid. & Deposit Co. of Md.*, ___F.3d ___, 2009 U.S. App. LEXIS 24329 (2d Cir. Nov. 5, 2009). Affirming the lower courts and agreeing with a recent Ninth Circuit decision, the Second Circuit explained that the Bankruptcy Code (“Code”) “interposes no bar ... to recovery.” *Id.* at *12 (citing *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 452 (2007) (“[C]laims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed.”)).

RELEVANCE

Lenders, financial advisers, accountants, indenture trustees and other professionals who bargain for reimbursement of their legal fees should be reassured by *Ogle*. Lower courts in the Second Circuit and elsewhere had previously disallowed creditors’ professional fees, wrongly holding that: 1) nothing in the Code authorizes the payment of these fees; and that 2) contractual rights to these fees are unenforceable. *See, e.g., J.P. Morgan Trust Co., N.A. v. A.P. Green Indus., Inc.*, No. 06-0885,

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Credit (Bid) Where Credit’s Due

Part One of a Two-Part Article

By James H.M. Sprayregen, Christopher J. Marcus, David A. Agay and Benjamin J. Steele

The recent turn in the credit cycle has featured more complex capital structures with multiple tranches of secured debt. For years, commentators have written about the proliferation of secured debt and considered how this would impact in-court and out-of-court restructurings. However, few commentators foresaw the current issues swirling around an aspect of the Bankruptcy Code — credit bidding — that prior to the recent bankruptcy wave rarely drew much attention. This article focuses on the ability of a secured creditor to credit bid its claims at a sale under § 363(k) or § 1129(b)(2)(A)(ii).

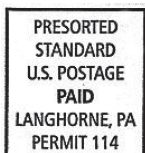
CREDIT BIDDING UNDER THE CODE

Under § 363(k), “unless the court for cause orders otherwise,” the holder of a secured claim can use its claim as currency in a bankruptcy sale and bid in (*i.e.*, credit bid) the par value of the claim at the sale, irrespective of the value ascribed to the collateral. Under § 1129(b)(2)(A)(ii), a debtor may “cram down” a Chapter 11 plan notwithstanding the non-acceptance of such plan by a secured creditor class, where the plan provides for the sale of property securing such claims, subject to § 363(k), with any liens attaching to the proceeds of such sale. Under both sections, a lender’s ability to credit bid protects the lender’s view of the valuation of its collateral at a sale of that collateral, by allowing the lender to retain the collateral if the proposed purchase price is, in its view, too low. In effect, assuming the court does not find “cause” to order otherwise, Sections 363(k) and 1129(b)(2)(A)(ii) give a secured creditor a statutory right of first refusal to purchase its collateral in a bankruptcy sale. While a full consideration of “cause” under § 363(k) to preclude a secured creditor from credit bidding falls beyond the scope of this article, courts can find cause where the creditor’s lien is questioned or otherwise in dispute. *See, e.g., In re Akard St. Fuels, L.P.*, 2001 WL 1568332 (N.D. Tex. 2001)

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Credit Bid

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(denying secured creditor's right to credit bid where its liens were the subject of a bona fide dispute); *In re McMullan*, 196 B.R. 818 (Bankr. W.D. Ark. 1996) (denying secured creditor's right to credit bid where the validity of its liens was in question); *In re Diebart Bancroft*, 1993 WL 21423 (E.D. La. 1993) (allowing secured creditor to credit bid but requiring bid to include enough cash to cover potential lien challenge, with cash held in escrow until lien challenge resolved).

This two-part article focuses on two issues that are the subject of recent court decisions: 1) a majority group of secured lenders under a credit facility "dragging along" the minority group into a credit bid under § 363(k); and, in Part Two, 2) the ability of a debtor to prevent a secured creditor from credit bidding at a sale under a plan by providing the creditor with the indubitable equivalent of its claim under § 1129(b)(2)(A)(iii).

RECENT DRAG-ALONG CASES

The recent cases involving over-leveraged companies and under-secured creditors have resulted in lenders being more willing to own and operate their collateral. In addition, financial and strategic investors have seen opportunities to buy distressed debt at a discount, with the aim of using that debt as currency in a bankruptcy sale. The application of credit bidding at a sale is relatively straightforward where an asset is encumbered by one lien held by one creditor. However, difficult questions quickly arise where

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multiple tranches of liens encumber the same assets, and each lien secures debt held by multiple parties. For example, who has the right to actually bid in the debt — the agent or indenture trustee under a syndicated credit facility or note issuance, or the actual lenders or note-holders themselves? Can a credit bid be made where certain holders do not support the credit bid and, if so, what value will the non-participating holders receive on account of their claims? And in what form of currency will that value be delivered? Credit and security agreements generally have not expressly addressed these issues. In recent decisions, the trend has been for courts to allow secured creditors to participate in § 363 sales of their collateral and act on their assessment of asset values while facilitating sales that maximize estate value. In these cases, courts have focused on the language of the relevant credit agreements in permitting credit bids backed by groups of lenders directing an agent or indenture trustee.

In re Chrysler LLC

While not a credit bidding case, *In re Chrysler LLC*, 576 F.3d 108 (2d Cir. 2009) endorsed the notion of a trustee or agent vested with authority under the applicable agreements to take action on behalf of the lender group. In doing so, the Second Circuit enunciated the reasoning for permitting a majority (in dollar amount) of holders under a facility to direct the agent or trustee to "drag along" non-participating holders into a credit bid.

In *Chrysler*, a majority of the lenders under the first lien credit agreement instructed the agent to release collateral to the buyer in exchange for a cash recovery well below the par value of the debt. The holdout lenders insisted that such action required amendment or waiver of the credit agreement (which required a unanimous vote of the lenders) and thus that the agent could not release the collateral at the direction of only a majority. The Second Circuit disagreed. In so holding, the panel affirmed the bankruptcy court ruling,

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Restructuring in Canada

The (Updated) Insolvency System North of the Border

By Aubrey Kauffman

Canada and the United States are one another's largest trading partners. The rate of investment by Canadian companies in the United States and American companies in Canada continues to grow. With economies that are joined at the hip, financial downturns in one jurisdiction impact stakeholders in both.

The current economic crisis has amplified this dynamic. Cross-border filings in the manufacturing, forestry, energy and retail sectors are mushrooming. Virtually every significant recent restructuring filing has a cross-border element.

This article is an attempt to familiarize American readers with some of the nuances and new amendments you may encounter if you are involved in a Canadian insolvency situation.

CANADA AND THE U.S.

When it comes to restructuring, while there are many similarities between the Canadian and American systems, there are some material differences in approach and process that must be appreciated. In certain cases, the same words (for example, DIP financing) have quite different meanings or nuances.

As in the United States, insolvency laws in Canada deal with both restructurings and liquidations. In Canada, there are two statutes governing restructurings: the Companies' Creditors Arrangement Act (CCAA) and Part III of the Bankruptcy and Insolvency Act (BIA Proposals). After extensive delay, wide-ranging

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amendments were proclaimed in force effective Sept. 18, 2009. This paper incorporates a sampling of those amendments, along with a few of the differences you may experience when involved in an insolvency in Canada, particularly under the CCAA.

CROSS-BORDER INSOLVENCIES

The existing provisions dealing with cross-border restructurings have been substantially amended. Section 18.6 of the CCAA has been replaced by Part IV – Cross-Border Insolvencies. Part IV is based on the UNCITRAL Model Law and is very similar to Chapter 15 of the U.S. Bankruptcy Code.

There is a nuanced difference between Part IV and Chapter 15. Under Part IV, the Canadian court must be satisfied that the proceeding to be recognized is a "foreign proceeding." Once this determination is made, the court decides whether the foreign proceeding is a "foreign main proceeding" or a "foreign non-main proceeding." Thus in Canada, unlike the Bear Stearns scenario, no foreign proceeding will be refused recognition in Canada. As part of this distinction, there is no requirement for the foreign representative to prove an "establishment" in the foreign jurisdiction. A foreign non-main proceeding is simply a foreign proceeding that is not a main proceeding.

Although not expressly provided for in the CCAA, the practice has developed to appoint an "information officer" to periodically report to the Canadian court and creditors on developments in the foreign proceeding. This practice will probably be continued under the new regime.

THE CCAA: A UNIQUELY CANADIAN PROCESS

Generally, the CCAA is used for restructuring more complex companies (Air Canada, Stelco, Calpine, Nortel), while smaller or less complex filings can be filed under the Bankruptcy and Insolvency Act, or BIA. Both regimes provide for debtor in possession restructuring under the supervision of the court. The CCAA will undoubtedly remain the process of choice in more complex filings.

In essence, the CCAA provides a general framework for restructuring that includes a stay of proceedings to permit the debtor to file a plan of compromise or arrangement (Plan) with its creditors. Beyond the general framework, the CCAA has very few statutory rules compared with the U.S. Bankruptcy Code, and leaves a tremendous amount of discretion in the hands of the court.

Our American clients tend to find the CCAA process somewhat disconcerting, because the United States Bankruptcy Code provides a rule-based regime where virtually every aspect of a restructuring is regulated. Results are (theoretically) predictable. In CCAA restructurings, there is a great deal of flexibility left to the discretion of the judge shepherding the case. This can be bad in terms of predictability, but can be good in terms of flexibility and innovative solutions. The Canadian approach also seems to encourage more negotiated resolutions, and for this reason, restructurings under the CCAA are usually completed much more rapidly than American restructurings.

The amendments to the CCAA have expanded the provisions of the act from 22 sections to 63. Many practices under the act previously grounded in judicial discretion and inherent jurisdiction, such as the granting of DIP charges and administration charges, are now codified by the amendments. There is concern that codification of these practices will reduce the flexibility that is the hallmark of a CCAA restructuring. Time will tell whether this occurs.

COMMENCEMENT OF THE RESTRUCTURING PROCESS

A CCAA proceeding is usually started by a debtor seeking an Initial Order. The Initial Order declares that the debtor qualifies for relief under the CCAA. The Initial Order will authorize the debtor to develop and file a plan of arrangement or

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compromise with its creditors. The application for an Initial Order must be accompanied by a statement indicating the projected cash flow of the debtor and copies of its most recent financial statement. To qualify for an Initial Order, the debtor must be insolvent, have debts exceeding \$5 million and be a Canadian company or a company carrying on business in Canada.

On an application for an Initial Order, the applicant must satisfy the court that circumstances exist that make the order appropriate. The court must consider whether the relief is warranted. Initial Orders are generally granted, though in some cases an order may not be made where the prospect of restructuring is hopeless.

The new CCAA amendments codify existing-practice with respect to granting various judicial charges such as for DIP financing or administration expenses. However, the amendments now contain express requirements to give notice if secured creditors are to be affected. In urgent cases, Canadian practice may evolve into a more U.S. style of granting interim orders and then final orders for these charges. This will require a change to existing practice and much more widespread service.

STAY OF PROCEEDINGS

One of the most important aspects of the Initial Order is the stay of proceedings. The CCAA stay is extremely broad. It commonly stays all legal proceedings as against the debtor and the enforcement of private remedies. A stay under the CCAA cannot, however, restrain a person from calling on a letter of credit that is held by a third party in relation to the debtor, nor does it apply to “eligible financial contracts” (e.g., swaps).

In addition, the stay provides for, in essence, a mandatory injunction requiring suppliers to continue to provide goods and services, provided that there is no obligation on any party to provide goods or services on credit. No party may terminate an agreement with the debtor simply by reason of the commencement

of proceedings under the CCAA or that the debtor is insolvent.

The term of the stay in the Initial Order is 30 days. The stay provisions of the Initial Order can thereafter be extended for any duration from time to time, on application of the debtor. The CCAA does not impose limits on the number of extensions that may be granted or on the total duration of the process. On each request for an extension, however, the debtor must establish that it is progressing in its efforts to formulate a Plan and that it is acting in good faith. It is safe to say that most CCAA proceedings do not exceed one year.

The Air Canada filing, which was one of the most complex Canadian restructurings, took 17 months from the Initial Order to the final approval of the Plan. The Canadian process can be substantially faster than the US experience.

DISCLAIMER OF CONTRACTS

The amended CCAA now provides for an express statutory right to disclaim contracts. The new provisions set out a notice process, with access to the court if the disclaimed counterparty objects to the disclaimer (unlike U.S. practice, there is no need to get an order permitting the disclaimer of each contract).

Claims arising from the disclaimer will be dealt with in the Plan. Special protection is provided to executory intellectual property or license agreements. The disclaimer of such contracts will not affect the rights of a counterparty, provided such counterparty is prepared to comply with its obligations.

Previous uncertainty with respect to whether collective agreements can be repudiated is resolved by the amendments. Unlike the U.S. process, a collective agreement cannot be repudiated or amended without the consent of the union. It is anticipated that this clarification will make restructurings within a union environment more challenging in Canada and may drive strategic decisions to file in the U.S.

ASSIGNMENT OF CONTRACTS

Historically, there was no ability under the CCAA to force the assignment of an executory contract (either with respect to real property or per-

sonal property) without the consent of the counterparty — where such consent was required contractually. The amended CCAA now provides a statutory right to assign contracts if a statutory test is met. The test requires evidence that the proposed assignee can perform the contract, that it is appropriate to assign the contract and that all monetary defaults will be remedied. The assignment provisions do not apply to eligible financial contracts, collective agreements or contracts which are not assignable by their nature.

Two notable areas where Canadian restructuring practice varies significantly from U.S. practice are: 1) the role of the “monitor”; and 2) the absence of mandatory unsecured creditors’ committees.

As part of the Initial Order, the court must appoint a monitor for the purpose of monitoring the debtor’s business and financial affairs during the restructuring. The monitor is usually an insolvency practitioner from an accounting firm. The monitor must be a trustee, licensed under the BIA, and cannot have been the debtor’s auditor within the previous two years (without court dispensation).

There is no requirement or provision under Canadian law for an unsecured creditors’ committee funded by the debtor. Recently, ad hoc creditors’ committees have been organized in larger cases. These committees are generally informal and self-funding. In some cases, however, the debtor has been directed by the court to fund these committees where, for example, the committee represents the interests of former employees or retirees.

DIP FINANCING

The Initial Order (or a subsequent order) may also provide for DIP financing. This is one area where Canadian and American lawyers use the same word to describe a similar but somewhat different concept.

Section 11.2(1) of the CCAA now expressly provides for a DIP charge and specifies the test to be applied by the court. In Canada, the DIP lender is usually the pre-filing senior secured creditor and is granted a super priority for the DIP loan ahead

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of all existing secured creditors. There is no concept of “adequate protection” in Canada. Having said that, the court will be reluctant to grant priming DIP financing in the face of strong objections by secured creditors whose security value will be eroded. As well, the DIP charge cannot secure an obligation in existence prior to the DIP order.

Canadian courts have become sensitive to allowing cross-border DIP facilities to drain value from Canadian assets for the benefit of U.S. creditors. Unless there is a benefit to Canadian entities the courts have been reluctant to allow Canadian entities to pledge their assets to support a U.S. DIP facility.

THE INTRODUCTION OF ‘CRITICAL SUPPLIERS’

The amendments have added the concept of a critical supplier into Canadian restructurings. A supplier designated by the court as a critical supplier must continue to supply on existing terms, or terms set out by the court. Post-filing amounts owed to critical suppliers will be secured by a court ordered charge. The change does not cover pre-filing debts. The ranking of this charge is not specified, but will probably be high ranking.

Many CCAA proceedings do not result in a traditional restructuring of the debtor. It is now common for businesses to be sold, in whole or in part, during the CCAA process with the Plan constituting a distribution of proceeds (if there is a Plan at all). There is a perception that more val-

ue can be obtained for an enterprise through a sale during a restructuring process than through a sale in a receivership process.

There are also technical reasons why a sale in a CCAA process is preferable. The amendments now codify this existing practice. The interim sale of assets is similar in concept to a sale of assets under Section 363 of the Bankruptcy Code, although the elaborate stalking horse process used in such sales is generally not used in Canada. Recent cross-border cases such as *Nortel* and *Eddie Bauer* demonstrate how seamlessly such sales of Canadian and U.S. assets can be coordinated.

THE PLAN

Generally, the CCAA does not set out guidelines or rules for what can be in the Plan. While it does require the inclusion of some provisions with respect to payment of certain wage arrears and pension contribution arrears in order to obtain court approval, the structure of the Plan is left to the ingenuity of the drafter.

The Plan sets out the classes of creditors and the proposed treatment of each class. Typically, a Plan may propose:

- a cash payment of a percentage of the debt;
- a basket of cash or assets divisible among a class of creditors;
- a partial cash payment up front and a payment in the future on some basis; and/or
- a conversion or partial conversion of debt to equity.

The Plan may contain releases (including releases of directors and non debtor third parties) and in-

junction/exculpation provision to support the releases.

It can be conditional upon certain events, such as obtaining the exit financing.

COURT APPROVAL

If the Plan is passed by the creditors, it must be sanctioned (approved) by the court. Although the court places great weight on the decision of the creditors, the approval process is not a rubber stamp. The court must be satisfied that the Plan is “fair and reasonable.” It is at this stage that creditors that have been “swamped” can take the position that the Plan is *not* fair and reasonable. The amendments enumerate certain conditions that must be satisfied if the court is to approve the Plan — such as payment of certain wage arrears and pension obligations.

The monitor must file a report with the court setting out its recommendations with respect to the Plan. That report contains a liquidation analysis in order to demonstrate that the provisions of the Plan are superior to a liquidation.

STAY FAMILIAR, STAY UPDATED

Hopefully, this article will assist in answering some of your basic questions and will help you identify issues and opportunities in your business dealings. Given the many shifts in Canadian insolvency law in September 2009, it is imperative to keep updated on changes to the restructuring process, particularly as more large companies undoubtedly have difficulty navigating the rough economic waters into 2010.



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wherein Judge Arthur J. Gonzales stated: “The Court concludes that the purpose of the relevant provisions of the [credit, collateral and security agreements] is to have the Administrative Agent and Collateral Trustee act in the collective interest of the lenders. Restricting enforcement to a single agent to engage in unified action for the interests of a group of lenders, based upon a majority vote,

avoids chaos and prevents a single lender from being preferred over others.” *In re Chrysler LLC*, 405 B.R. 84, 103 (Bankr. S.D.N.Y. 2009)

GWLS and Metaldyne

The Second Circuit’s decision in *Chrysler* adhered to the rationale advanced by bankruptcy courts in approving “drag-along” bids by agents on behalf of majority lenders, and also set the stage for subsequent endorsements of this approach. In *In re GWLS Holdings, Inc.*, 2009 Bankr. LEXIS 378 (Bankr. D. Del. Feb. 23, 2009) and

In re Metaldyne Corp., 409 B.R. 671 (Bankr. S.D.N.Y. 2009), Judge Peter Walsh and Judge Martin Glenn, respectively, found that language in loan documents similar to the language at issue in *Chrysler* permitted a majority of lenders to instruct the agent to submit a credit bid under § 363(k) on behalf of all lenders and concurrently release liens on collateral as part of that transaction. Among other rationale, this authority was found under the loan documents pursuant to the

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agent's power to dispose or deliver the collateral on behalf of the lenders under any "applicable law," which the *GWLS* and *Metaldyne* courts determined included the Bankruptcy Code. As in *Chrysler*, the courts in *GWLS* and *Metaldyne* overruled the objection of dissenting lenders, who argued that the actions of the majority lenders effected an amendment or waiver of the loan documents and thus required unanimous consent of the lenders. It is worth noting that the credit bidding lenders in *Metaldyne* did not have senior liens on all of the assets being purchased. Certain of *Metaldyne's* non-bidding lenders (including its DIP lenders) held senior, priming liens on certain assets included in the sale. As a result, the bidding lenders (with junior liens on certain assets) included a cash component sufficient to repay the claims secured by the senior liens. With those senior claims repaid in cash, the sponsors could obtain *Metaldyne's* assets free and clear of liens, claims, and other encumbrances under § 363(f).

AN AFFIRMATION WITH A DIFFERENT RESULT

The approach of relying on prepetition credit agreements was recently reaffirmed, with a somewhat different result, in *In re Electroglas, Inc.*,

No. 09-12416 (PJW) (Bankr. D. Del. Sept. 23, 2009). In *Electroglas*, Judge Walsh ruled that holders of secured notes issued by *Electroglas* could not bypass the indenture trustee and directly credit bid their claims at a § 363 sale of their collateral. In doing so, Judge Walsh denied two competing groups of noteholders the right to credit bid, each of which had attempted to credit bid its claims without the indenture trustee. Even though one noteholder group controlled a majority of the notes, Judge Walsh held that the majority group could not force the indenture trustee to credit bid because the language of the indenture and security agreement only allowed a majority group of noteholders to prescribe procedures for the trustee's enforcement of remedies, not to direct the trustee to take substantive action. Judge Walsh found that the language of the indenture provided the lenders with a right to request that the trustee take certain action to exercise remedies, such as submitting a credit bid at a sale of the collateral, but that the discretion to act belonged solely to the trustee. Furthermore, it appears from Judge Walsh's opinion that the majority noteholders never formally requested that the trustee submit a credit bid. Thus, *Electroglas* is consistent with *GWLS* and *Metaldyne* in that the court, guided by the terms

of the prepetition credit agreement, held that only the indenture trustee under a syndicated loan facility had the authority to submit a credit bid.

OTHER CASES

In other cases, such as *In re Foamex Int'l Inc.*, No. 09-10560 (KJC) (Bankr. D. Del.) and *In re Propex Inc.*, No. 08-10249 (JCC) (Bankr. E.D. Tenn.), a majority of lenders directing the administrative agent funded pro rata cash recoveries for lenders that decided not to participate in the credit bid and receive equity in the new company owning the debtor's assets. This structure allows non-participating lenders to opt out and receive a cash payment where they would otherwise be subject to the "drag-along" procedure effected in *GWLS* and *Metaldyne* (and attempted in *Electroglas*). While this structure requires participating lenders to put up more cash than a pure credit bid, such lenders receive more equity than that to which they would otherwise be entitled on account of their loan holdings.

Ultimately, these cases demonstrate that, to date, courts have relied on prepetition credit contracts in ascertaining and applying credit bid rights in bankruptcy cases.

Next month's discussion concludes with a look at indubitable equivalent cases.



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slip op. at 4 (W.D. Pa. Nov. 5, 2007) (affirmed bankruptcy court's denial of indenture trustee's reimbursement claim for legal fees; "Under the maxim of *expressio unius est exclusio alterius* (the expression of one is the exclusion of the alternatives), silence as to undersecured claims for attorneys' fees and costs in [Code] § 506(b) indicates that they are excluded from payment."; a case the author succeeded in losing, *In re Crafts Retail Holding Corp.*, 378 B.R. 44, 50 (Bankr. E.D.N.Y. 2007) ("[A]bsent statutory authority, [financial adviser's] claimed contractual rights or asserted principles of equity alone do not constitute cognizable bases for an award

of compensation or reimbursement of expenses in bankruptcy cases."). According to the Second Circuit, the appellate courts have been "closely divided on the" issue of post-bankruptcy fees. *Ogle* at *7. *Compare In re SNTL Corp.*, 571 F.3d 826, 839-45 (9th Cir. 2009) (allowing unsecured guarantor's reimbursement claim for post-petition attorneys' fees based on pre-petition contract); *Martin v. Bank of Germantown*, 761 F.2d 1163, 1168 (6th Cir. 1985) ("... creditors are entitled to recover attorneys' fees in bankruptcy claims if they have a contractual right to them valid under state law ..."; collection costs and legal fees in lender's note); *In re Shangra-La, Inc.*, 167 F.3d 843, 848-49 (4th Cir. 1999) ("Entitlement to attorneys' fees ... depended on ... terms of [contract] and on state law."),

with *Adams v. Zimmerman*, 73 F.3d 1164, 1177 (1st Cir. 1996) (disallowing claim for post-insolvency fees against FDIC receiver; non-bankruptcy case), and *In re Waterman*, 248 B.R. 567, 573 (B.A.P. 8th Cir. 2000) (allowing claim for post-petition fees under Code § 506(b) only because creditor was oversecured).

FACTS

In *Ogle*, the contractual entitlement to attorneys' fees arose from a series of pre-bankruptcy agreements between Fidelity and Agway. In exchange for Fidelity's providing surety bonds to Agway's insurers, Agway agreed to indemnify Fidelity for any payments made under the bonds plus any legal fees incurred enforcing the agreements. *Ogle*,

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2009 U.S. App. LEXIS 24329, at *4. After filing its Chapter 11 petition, Agway defaulted on its obligations to the insurers. Fidelity complied with its obligation under the bonds, and tendered payment to Agway's insurers. Fidelity's efforts to enforce its indemnity rights against Agway, however, resulted in protracted litigation during which Fidelity incurred costs, including attorneys' fees. *Id.* The Agway liquidating trustee conceded that Fidelity was entitled to the fees under state contract law, but argued that the Code barred Fidelity's recovery. *Id.* The Second Circuit considered the following narrow issue: "Under the Bankruptcy Code, is an unsecured creditor entitled to recover post-petition attorneys' fees that were authorized by a pre-petition contract but were contingent on post-petition events?" *Id.* at *5-*6.

ASSERTEDLY RELEVANT CODE PROVISIONS

Code § 502(b): Right To Payment. The court first rejected the trustee's argument that Code § 502(b) precluded the legal fees sought by Fidelity. Quoting the Supreme Court in *Travelers*, the court noted that the Code defines "claim" to be a "right to payment," which "usually refer[s] to a right to payment recognized under state law." *Id.* at *8 (*Travelers*, 549 U.S. at 451) (internal quotation marks omitted).

Contingent Claims Allowable. That the creditor's claim here was contingent was also unimportant. As the court explained, the Code § 101(5)(A) includes "contingent" claims in its definition of "claim." *Id.* Because applicable state contract law gave the creditor here a right to payment when the indemnification agreement was signed, the creditor "possessed a contingent right to post-petition attorneys' fees," although "its right arose pre-petition." *Id.* at *9. Moreover nothing in Code § 502(b) precludes an unsecured

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creditor's "recovery of post-petition attorneys' fees" because the claim was contingent. *Id.* at *9-*10. Accord, *In re SNTL Corp.*, 571 F.3d 826, 838 (9th Cir. 2009) ("Under section 502(b)(1), those contingent claims cannot be disallowed simply because the contingency occurred postpetition Contingent claims are allowed under Section 502(b)"). In the Second Circuit's reading of the Supreme Court's *Travelers* opinion, it had to "presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed." 2009 U.S. App. LEXIS 24329, at *15.

INAPPLICABILITY OF CODE EXCEPTIONS TO ALLOWABILITY

Moreover, none of the exceptions to the allowability of a claim listed in § 502(b) applied to the claim here. Although § 502(b)(1) makes any defense to a claim available to a bankruptcy trustee, unless applicable state law or one of the exceptions in § 502(b) applies, "the claim must be allowed." *Id.* at *9-*10 (quoting *Travelers*, 549 U.S. at 452).

The court's reasoning is straightforward:

The underlying contract is valid as a matter of state substantive law; none of the § 502(b)(2)-(9) exceptions apply; and the Code is silent as to the particular question presented ... whether the Code allows unsecured claims for fees incurred while litigating issues of contract law more generally.

Id. at *11-*12 (internal quotation marks omitted).

Code § 506(b) Not Applicable. The court also rejected the trustee's reliance on Code § 506(b), which only bars interest on an undersecured creditor's claim. Because Code § 506(b) "does not implicate unsecured claims for post-petition attorneys' fees," reasoned the court, it thus "interposes no bar to recovery." *Id.* at *13. Accord, *In re SNTL Corp.*, 571 F.3d at 841 ("... we reject the argument that section 506(b) preempts postpetition attorneys' fees for all except oversecured creditors."), citing *In re 268 Ltd.*, 789 F.2d 674,678 (9th Cir. 1986) (§ 506(b) does not "limit the fees available" as an unsecured

claim but merely "define[s] the portion of the fees [to] be afforded secured status."); *In re Welzel*, 275 F.3d 1308, 1316-20 (11th Cir. 2001) (§ 502(b) "does not ... disallow attorneys' fees of creditors ...").

Nor does the Supreme Court's holding in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) (held, § 506(b) permitted post-bankruptcy interest to be paid only from equity cushion; undersecured creditor could not get post-bankruptcy interest) mandate disallowance of unsecured claims for post-bankruptcy legal fees. Although § 502(b)(2) "specifically disallows claims for unmatured interest," § 502(b) "does not contain a similar prohibition against attorneys' fees." *SNTL Corp.*, 571 F.3d at 844. As the Second Circuit noted in *Ogle*, "while section 502(b)(2) bars claims for unmatured interest, it does not similarly bar (or even reference) claims for post-petition attorneys' fees." 2009 U.S. App. LEXIS 24329, at *14-*15.

POLICY ARGUMENT

Finally, the court rejected the trustee's policy argument that allowance of the fees here would "unfairly disadvantage other creditors ... whose distributions would be reduced." *Id.* at *15. Here, sophisticated parties negotiated an agreement with a provision for the recovery of legal fees. The creditor will not be receiving an undeserved bonus at the expense of others. Allowance of the claim "merely effectuates the bargained-for terms of the [pre-bankruptcy] loan contract." *Id.* at *16 (quoting *In re United Merchants & Mfrs., Inc.*, 674 F.2d 134, 137 (2d Cir. 1982) (pre-Code case)). See *SNTL Corp.*, 571 F.3d at 845 ("... the Bankruptcy Code itself [does] not specifically disallow ... postpetition fees In the end, it is the province of Congress to correct statutory dysfunctions and to resolve difficult policy questions embedded in the statute.").

HOW OTHER COURTS HAVE STRUGGLED

Some lower courts have simply ignored the Supreme Court's March 20, 2009 *Travelers* decision. See, e.g.,

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A.P. Green Industries, supra (Section 506(b), dealing with a secured creditors' claim for legal fees, "controls over the general statute, section 502(a)"; secured creditors "are able to collect [legal fees] only to the extent that there is a security cushion from which they can be paid"; "to allow contractual claims for attorneys' fees ... would impair the debtor's fresh start ... while treating similarly situated creditors differently."). Another court asserted, despite the *Travelers* holding, that it had never approved a pre-bankruptcy contractual legal fee reimbursement clause and that, in any event, the clause "was not in compliance with federal bankruptcy law, *i.e.*, [Code] §§ 327 and 330." *Crafts Retail*, 378 B.R. at 51 (relying on *In re United Merchants & Manufacturers, Inc.*, 597 F.2d 348 (2d Cir. 1979) (denying legal fees to indenture trustee), but ignoring *In re United Merchants & Manufacturers, Inc.*, 674 F.2d 134, 138-39 (2d Cir. 1982) (" ... we find no law or policy that supports the ... disallowance of ... claims ... for collection costs under ... the loan agreements"; distinguished compensation for expenses in administering estate from "claims [that] are part of the contractual indebtedness [to creditors], and [thus] not subject to the statutory limitations on reimbursement for expenses of administering the estate.").

The bankruptcy court in *Crafts Retail* also stressed the lack of an express Code provision authorizing the reimbursement of a financial adviser's pre-bankruptcy contractual claim for post-bankruptcy legal fees. 378 B.R. at 44. In its view, the "morphing of attorney compensation into a garden variety expense item is unacceptable" *Id.* Other bankruptcy courts reached similar conclusions. *In re Elec. Mach. Enter., Inc.*, 371 B.R. 549, 551-52 (Bankr. M.D. Fla. 2007) (stating that Supreme Court in *Travelers* "declined to express an opinion on whether unsecured cred-

itors are entitled to post-petition attorneys' fees"; "plain language" of § 506(b) precludes claims); *In re Pride Cos., L.P.*, 285 B.R. 366, 372-75 (Bankr. N.D. Tex. 2002) (collecting cases and citing James Gadsden, "Recovery of Attorney Fees As an Unsecured Claim," 114 Banking L.J. 594, 603 (1997), for its description of a "perceived unfairness" by some courts when disallowing "postpetition attorneys' fees to unsecured creditors"; court also rejected Second Circuit's 1982 *United Merchants* decision for its questionable "logic and importance.").

Other lower courts, however, have noted the unfairness of denying legal fees to such pre-bankruptcy creditors as financial advisers. Indeed, one court stressed why, as a matter of fairness, these claims should be enforced:

There is no provision in the Code for a professional appointed pursuant to Section 327 to seek appointment of another professional to represent its interests at a fee hearing. For attorneys this is not a problem because they are usually well equipped to represent themselves at fee hearings, and they are permitted to seek reimbursement for reasonable fees and expenses incurred in the preparation and defense of their applications *To expect [the financial adviser], a non-attorney professional, to either accept representation from counsel who may suffer a conflict of interest or absorb the cost of representation itself is fundamentally unfair.* This is especially true in light of the engagement agreement which specifically provided for reimbursement of such fees by [the debtor]. Accordingly, the Court will allow the reimbursement of reasonable fees and expenses incurred by [counsel] in defense of [the adviser's] fee application.

In re Geneva Steel Co., 258 B.R. 799, 803 (Bankr. D.Utah 2001) (Clark, Ch.J.) (emphasis added); *In re EWI, Inc.*, 208 B.R. 885, 895 (Bankr. N.D.

Ohio 1999) ("The Court has found that the debtor has a contractual basis to pay [the adviser] for reasonable legal fees"; reasonable fee of counsel in preparing fee application allowed).

The Eleventh Circuit also remanded to the bankruptcy court on appeal "to reconsider [a financial adviser's] request for reimbursement of attorneys' fees amounting to \$110,351.80 with consideration of the detailed itemization the district court noted in its opinion." *In re Citation Corp.*, 493 F.3d 1313 (11th Cir. 2007). In *Citation*, the financial adviser had sought to be reimbursed for the fees it had paid its counsel. *Id.* at 1316. Because the "bankruptcy court found no itemization for these expenses," it denied the request. *Id.*, n.1. The district court, however, found that the bankruptcy court "must have overlooked [the adviser's] detailed itemization of its attorney's fees ... filed with the court." *Id.* Accordingly, the district court held, and the court of appeals agreed, that "allowance of this amount shall be determined by the Bankruptcy Court" on remand. *Id.*

CONCLUSION

At least two, if not five, Circuits have now put to rest the contractual post-bankruptcy legal fee issue. But there is no uniformity yet, and some lower courts have strongly resisted or ignored appellate guidance from the Supreme Court in *Travelers* and from other courts when they could. Outside the Second, Fourth, Sixth, Ninth and Eleventh Circuits, the contractual legal fee issue is still unresolved. Because bankruptcy litigators thrive on this kind of uncertainty, they will continue to fight over the fee issue until other appellate courts either forge a consensus or until the Supreme Court weighs in to resolve a Circuit split. Despite assertions of unfairness, statutory construction and other technical arguments, *Ogle* and *SNTL* represent the sensible, better-reasoned judicial resolution of the contractual legal fee debate.



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