

Unsecured Creditors Beware! The Western District of Texas Bankruptcy Court Declares an Unsecured Creditor Cannot Have Its Cake and Eat It Too

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Bankruptcy courts have long debated the issue of whether an unsecured creditor can recover post-petition legal fees under the Bankruptcy Code. In the recent decision of *In re Seda France, Inc.* (located [here](#)), Justice Craig A. Gargotta of the United States Bankruptcy Court for the Western District of Texas denied an unsecured creditor's claim for post-petition fees. In doing so, the Court has once again left the unsecured creditor with a bad taste in its mouth by declaring that an unsecured creditor seeking post-petition fees is asking permission to have its cake (a claim for principal, interest and pre-petition legal fees under applicable loan documents) and eat it too (a claim for post-petition legal fees).

Proponents of the view that an unsecured creditor cannot recover post-petition legal fees point to section 506(b) of the Bankruptcy Code, which allows as part of a creditor's *secured* claim the reasonable attorneys' fees and costs incurred during the post-petition period, and note the Bankruptcy Code is silent on an *unsecured* creditor's right to post-petition legal fees. Essentially, the argument is since Congress provided for post-petition fees for secured creditors, it could have explicitly provided for post-petition fees for unsecured creditors but chose not to. Proponents of the alternative view cite the Second Circuit decision *United Merchants* and its progeny, where those courts refused to read the plain language of section 506(b) as a limitation on an unsecured creditor's claim for recovery of post-petition legal expenses. The theory is that while the Bankruptcy Code does not expressly permit the recovery of an unsecured creditor's claim for post-petition attorneys' fees, it does not expressly exclude them either. The basic tenant is that if Congress intended to disallow an unsecured creditor's claim for post-petition legal fees it could have done so explicitly.

In *Seda*, Aegis Texas Venture Fund II, LP ("Aegis") timely filed a proof of claim in Seda's Chapter 11 bankruptcy case claiming its entitlement to principal, interest and pre-petition attorneys' fees under its loan documents with Seda as well as post-petition attorneys' fees for the duration of the case. Aegis made various arguments in support of the allowance of its post-petition legal expenses including: (1) the explicit award of post-petition fees to secured creditors under section 506(b) does not mean that such a provision should not be implicitly read into section 502(b) (i.e., *unim est exclusion alterius* ("the express mention of one thing excludes all others") does not apply), (2) the United States Supreme Court decision in *Timbers* does not control as *Timbers* denied claims of an *undersecured* creditor for unmatured interest caused by a delay in foreclosing on its collateral, (3) the right to payment of attorneys' fees and costs exists pre-petition and it should be irrelevant to the analysis that such fees are technically incurred post-petition, (4) because the Bankruptcy Code is silent on the disallowance of an unsecured creditor's post-petition attorneys' fees, these claims should remain intact, and (5) recovery of post-petition attorneys' fees and costs is particularly appropriate where, as in *Seda*, the debtor's estate is solvent and all unsecured creditors are to be paid in full as part of a confirmed Chapter 11 plan.

The *Seda* Court rejected Aegis' arguments and held that an unsecured creditor is not entitled to post-petition attorneys' fees even where there is an underlying contractual right to such fees and unsecured creditors are being paid in full. With respect to Aegis' argument on the proper interpretation of sections 506(b) and 502(b), the Court cited the many instances in the Bankruptcy Code where Congress expressed its desire to award post-petition attorneys' fees (e.g., section 506(b)), and found

that Congress could have easily provided for the recovery of attorneys' fees for unsecured creditors had that been its intent. Regarding Aegis' argument that *Timbers* does not control, the Court held that in reaching its decision on the disallowance of a claim for unmatured interest the *Timbers* Court found support in the notion that section 506(b) of the Bankruptcy Code does not expressly permit post-petition interest to be paid to unsecured creditors. The *Seda* Court held this ruling should apply equally to attorneys' fees to prohibit recovery of post-petition fees and expenses by unsecured creditors. The Court further held that section 502(b) of the Bankruptcy Code provides that a court should determine claim amounts "as of the date of the filing of the petition," and therefore attorneys' fees incurred after the petition date would not be recoverable by an unsecured creditor. In response to Aegis' argument that non-bankruptcy rights, including the right to recover post-petition attorneys' fees should be protected, the *Seda* Court noted that the central purpose of the bankruptcy system is "to secure equality among creditors of a bankrupt" and that an unsecured creditor's recovery of post-petition legal fees, even based on a contractual right, would prejudice other unsecured creditors. The Court held this is true even in the case where the debtor was solvent and paying all unsecured creditors in full. The Court noted that a debtor's right to seek protection under the Bankruptcy Code is not premised on the solvency or insolvency of the debtor and, therefore, the solvency of the debtor has no bearing on the allowance of unsecured creditors' post-petition legal fees.

Seda is the latest installment in the continued debate among the courts whether to allow an unsecured creditor's post-petition attorneys' fees. The *Seda* Court is of the view that an unsecured creditor cannot recover post-petition legal fees for the foregoing reasons, most notably that the Bankruptcy Code is silent on their provision and public policy disfavors the recovery of one unsecured creditor's legal expenses incurred during the post-petition period to the prejudice of other unsecured creditors. Depending on the venue of the case, there will undoubtedly be many more instances of unsecured creditors seeking recovery of their post-petition attorneys' fees in a bankruptcy case until the Supreme Court definitively rules on the issue. Until then, keep asking for that cake

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