

Drafting Errors

Routinely Cost Lenders' Post-Bankruptcy Attorney's Fees and Interest



Government-guaranteed loan programs can provide a great avenue for lenders to enhance credit.

When a bankruptcy intervenes to prevent the continuation of a restructuring or loan enforcement effort, it is too late to supplement or strengthen loan documentation. Lenders are then stuck with what is — and sometimes more significantly — what is not in their existing loan documentation. Unfortunately, critical loan enforcement remedies and claim amounts may depend on not just the underwriting decisions relating to the loan itself or the value of any pledged collateral, but also on the scope and precision of what is sometimes derisively referred to as the “boilerplate provisions” in loan documents.

Sometimes lawyers prepare documents that contain paragraphs of mind-numbing complexity over simple, direct language. However, in the context of post-default loan enforcement, simple and direct language is at the core of the problem, resulting in omission or inadvertent waiver of important rights when the time comes to enforce the loan.

One of the most frequent examples of this phenomenon is the attorney's fees and

costs provisions contained in many standard promissory notes or credit agreements, which are very often a few words more or less than: “the lender shall be entitled to recover its attorney's fees and costs incurred in any litigation brought to interpret and enforce the loan or the loan documents.” This simple language may be fine, if the specific fees and costs incurred in a Superior Court enforcement action are all that are incurred. It will not be sufficient if extensive fees and costs are instead incurred in negotiating a restructuring, reviewing a recapitalization plan, a plan of reorganization or some other contested matter or adversary proceeding in a bankruptcy or receivership case.

Allowance of Post-Bankruptcy Attorney's Fees and Interest

In bankruptcy cases an oversecured lender is entitled to recover, as part of its allowed secured claim, interest, as well as its “reasonable” contractual attorney's fees — regardless of whether the interest accrues and the fees are incurred post-bankruptcy. See 11 U.S.C. Section 506(b). However, the particular amounts awardable as post-petition interest or attorney's fees and costs may depend on what the loan

documents expressly and specifically provide, as well as the context in which the language is being considered within the bankruptcy case. For example, the Ninth Circuit has ruled that an oversecured creditor is entitled to enforce a contractual default interest rate provision and is not limited to the pre-default rate *General Electric Capital Corp. v. Future Media Productions, Inc.*, 536 F.3d 9 (9th Cir. 2008), as amended at 547 F.3d 956 (9th Cir. 2008).

Five years ago the U.S. Supreme Court overruled lower court decisions that had held that a creditor's allowable bankruptcy claim could not include post-bankruptcy attorney's fees and costs incurred while litigating issues of federal bankruptcy law. *Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co.*, 549 U.S. 443 (2007). In *Travelers*, the Court found no authority under the Bankruptcy Code to support this categorical prohibition. More recently, *In re SNTL Corporation*, 571 F.3d 826, 845 (9th Cir. 2009), the Ninth Circuit ruled that post-bankruptcy fees and costs that are recoverable as falling within the scope of a creditor's contractual or statutory claims, may also be allowed under Section 502 as part of such creditor's claim, regardless of whether that claim is a general unsecured claim. However, the attorney's fee language in the loan documents must be broad enough to include that possibility. Simply providing that the lender can recover attorney's fees incurred in any litigation to collect the note may not be sufficient. Suggested language might say: If Lender retains an attorney to enforce its rights under the Note or other loan documents, or to protect its collateral, Lender shall be entitled to receive its reasonable attorney's fees and costs, regardless of whether suit is brought, and in any trial court, appellate court, bankruptcy court, arbitration or mediation.

Prepayment Premiums and Post-Judgment Default Interest

Default interest and prepayment premiums (sometimes referred to as “yield maintenance provisions” or, less charitably, “prepayment

penalties”) often generate significant controversy and scrutiny in bankruptcy cases, particularly where other creditors recoveries are significantly diminished if they are upheld. Here again, the language adopted in the loan documents can be of critical importance. If a large and arbitrary percentage is at the heart of a prepayment premium provision, the provision may be ruled punitive and unenforceable, and not compensatory and enforceable. *General Electric Capital Corp. v. Future Media Productions, Inc.*, 536 F.3d 9 (9th Cir. 2008), as amended at 547 F.3d 956 (9th Cir. 2008).

Lenders are often in federal court (U.S. District Court or Bankruptcy Court) enforcing their claims to judgment. Many assume that if successful, the post-judgment rate will be the contractual default rate, or at the very least, the contractual interest rate — not the feeble federal judgment rate (currently 0.15 percent per annum). At least, according to one court, the correctness of this assumption depends entirely on what the loan documents specifically provide — yet another instance of where more verbiage may be far preferable than simple and direct.

In *Cataphora Inc. v. Parker*, 848 F.Supp.2d 1064 (N.D. Cal. 2012), the District Court denied a lender plaintiff’s award of post-judgment interest at the 18 percent contractual rate. The court allowed only the applicable federal judgment rate (approximately 0.15 percent) for post-judgment interest. The court discussed that while state law governs pre-judgment interest on state-law claims in diversity cases, federal law governs post-judgment interest rates (see 28 U.S.C. Section 1961(a)). The Plaintiff recognized that

federal law governed post-judgment interest, but argued that the parties had contractually agreed to a different post-judgment rate of interest.

Here is the kicker: The court agreed that the parties can contractually waive the requirements of 28 U.S.C. Section 1961(a) in their negotiable documents. However, the court noted that relying on a provision for interest in the event of a late payment or default, rather than a provision that specifically dictates the pre-judgment or post-judgment interest rate in the event of a dispute arising out of the contract, is insufficient to contractually alter the otherwise applicable federal post-judgment interest rate. The court ruled that the plaintiff was only entitled to a rate equal to the weekly average one-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding the date of the judgment.

“Get it in writing” is legal wisdom that even the most unsophisticated client knows, but in these lean times, many lenders are under enormous budgetary pressure to reduce their costs, including outside legal costs. However, comprehensive loan documentation with standard terms and conditions reflective of recent legal developments is one of those areas where more is certainly never less; it is always more. 

