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A Lesson about a Secured Lender's Claim for Attorneys' Fees

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In the mundane world of interpretation of attorneys' fee provisions in credit agreements, a case occasionally comes along that reminds practitioners that such clauses can have important ramifications. In *In re Latshaw Drilling LLC*,[1] the bankruptcy court held that an oversecured lienholder/administrative agent (a Lehman Brothers affiliate) was entitled to recover a significant portion of its attorneys' fees pursuant to §§ 502 and 506(b) of the Bankruptcy Code, even though it would not have incurred such fees but for the lender's breach of its own obligations. Despite spending a significant portion of the opinion criticizing the lender for its overly aggressive conduct (*i.e.*, forcing a financially healthy borrower into bankruptcy) and excessive legal fees, the court ultimately held that under New York law, the plain language of the agreement "[did] not limit [the lender's] entitlement to reimbursement of its fees and expenses to situations in which it was not in default." Rather, the court held that the lender's legal fees, which it incurred primarily in defending the debtor's objection to its claim, were encompassed by the credit agreement's reference to fees that the lender realized "in its enforcement or preservation of any rights" under the agreement. The lead lender in *Latshaw* was able to force a financially healthy borrower into bankruptcy for the sole purpose of evading its own funding commitment, and it was able to recoup much of the legal fees that it incurred in doing so.

Like many other cases affected by the Lehman Brothers bankruptcy filing, *Latshaw* presents a situation rarely seen in published cased law—specifically, a scenario in which a majority member of a sophisticated lending syndicate (who constitutes the "required lenders" under the credit agreement) cannot fund its portion of the loan commitment. By finding that the lender is nevertheless able to recover its attorneys' fees incurred in enforcing the loan against the borrower, the *Latshaw* opinion proves that credit agreements are currently being enforced as lenders hope they are. But from the perspective of minority lenders, this is not necessarily all good news. In fact, it might be argued that *Latshaw* provides a blueprint for a defaulting majority lender to extract itself from a potentially messy situation and force a bankruptcy filing by the borrower that other syndicate members might not want.

Background

Pursuant to § 506(b), an oversecured creditor is entitled to "any reasonable fees, costs or charges provided for under the agreement or State statute under which such claim arose." Section 506(b) only applies to fees incurred post-petition. Pursuant to § 502(b)(1), a creditor can add to the amount of its allowed pre-petition claim any attorneys' fees incurred under "any agreement or applicable law." Because most states apply a reasonableness standard to fees awarded pursuant to fee-shifting provisions, there is generally not a material difference between the analyses under §§ 502(b) and 506.

State law (and New York law in particular) generally provides that when one party to a contract commits a material breach, the other party may either withhold its own performance, or it may continue to perform and then sue for damages.[2] However, there appears to be no case law providing that the breaching party may recover its attorneys' fees from the other party in an action stemming from the breaching party's own default, even if the

1 481 B.R. 765 (Bankr. N.D. Okla. 2012).

2 *ESPN Inc. v. Office of the Commissioner of Baseball*, 76 F. Supp. 2d 383, 387 (S.D.N.Y. 1999); *Merrill Lynch & Co. v. Allegheny Energy Inc.*, 500 F.3d 171, 186 (2d Cir. 2007) ("Under New York law, a party's performance under a contract is excused where the other party has substantially failed to perform its side of the bargain or, synonymously, where that party has committed a material breach.").

other party has also defaulted. In fact, there are cases stating that a party may not claim a benefit from a contract that it has already breached.[3] While that sounds intuitive, the *Latshaw* opinion shows that credit agreements can be drafted to circumvent this basic principle.

Facts of *Latshaw*

The debtor, Latshaw Drilling LLC, is in the business of leasing mobile drilling rigs. On July 11, 2008, Latshaw entered into a $100 million secured credit agreement (the "agreement") with a syndicate of lenders that included Lehman Brothers affiliate Lehman Commercial Paper Inc. (LCPI), with LCPI also serving as the syndication agent and administrative agent under the agreement. Until the debt was ultimately accelerated, Latshaw never defaulted on any of its payment obligations under the agreement.[4]

On Sept. 17, 2008, Latshaw submitted to LCPI a $37 million draw request under the agreement. While the other lender in the syndicate funded its ratable portion, LCPI failed to do so, thus defaulting on its commitment. Latshaw immediately notified LCPI of the default and demanded that LCPI advise it of whether it intended to fund its ratable portion of the commitment. LCPI did not respond. Subsequently, on Oct. 5, 2008, LCPI filed a chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of New York. Latshaw nevertheless continued to make payments under the agreement.[5]

Cleverly acting to extract itself from its predicament, LCPI embarked on a strategy of turning the tables on Latshaw. After a failed December 2008 attempt by the parties to reach an agreement that would have released LCPI from its funding commitment under the agreement, LCPI finally responded to Latshaw by a letter dated Feb. 13, 2009. In that letter, and in a series of subsequent letters over the next six months, LCPI declared Latshaw to be in default under the agreement due to several minor covenant violations that objectively had no bearing on Latshaw's ability to make payments under the agreement and that Latshaw could not cure.[6] When Latshaw then refused LCPI's restructuring proposal, LCPI accelerated the debt and began sweeping the cash in Latshaw's bank account,[7] which left Latshaw with no choice but to file for chapter 11 protection on Nov. 11, 2009.[8] It was undisputed that Latshaw never missed a payment under the credit agreement before the debt was accelerated, nor was there any inkling of financial distress prior to the liquidity drain resulting from LPCI's enforcement efforts.[9]

In Latshaw's bankruptcy case, LCPI sought reimbursement of its pre-petition attorneys' fees pursuant to § 502(b) and its post-petition attorneys' fees under § 506(b), in each case invoking section 9.5(b) of the agreement, which provided:

> [The] Borrower agrees ... to pay or reimburse each Lender and the Agents for all their reasonable out-of-pocket costs and expenses incurred in connection with the *enforcement or preservation* of any rights under this Agreement, the other Loan Documents and any other documents prepared in connection herewith or therewith, including, without limitation, the reasonable fees and disbursements of counsel to each Lender and of counsel to the Agents.[10]

LCPI incurred attorneys' fees as a result of, among other things, (1) taking pre-petition actions to enforce Latshaw's purported defaults under the agreement, (2) litigating Latshaw's objection to LCPI's claim (which was ultimately settled) and (3) objecting to Latshaw's disclosure statement. Not surprisingly, Latshaw objected to LCPI's recovery of any such fees, arguing that LCPI would not have had to incur any attorneys' fees whatsoever had LCPI not first breached the agreement. LCPI countered that it incurred the fees in its "enforcement or preservation of any rights" under the agreement. Thus, the court was faced with the issue of "whether LCPI's efforts to defend itself against Latshaw's pursuit of redress for the breach, and LCPI's efforts to establish the validity and amount of its claim in Latshaw's bankruptcy case (which Latshaw contested only because of LCPI's breach) can be characterized as 'enforcement or preservation'"[11] of LCPI's rights under the agreement.

The Holding

The court agreed that LCPI would not have incurred the attorneys' fees were it not simply looking for a reason to escape from its own default. The court also examined LCPI's claim for legal fees in minute detail, and disallowed various components where it found them to be unreasonable. Nevertheless, in answering the fundamental question of whether LCPI was entitled to recover its attorneys' fees at all, the court found that under New York law, the plain language of the agreement entitled LCPI to reimbursement of a large portion of the attorneys' fees that it sought to include in its claim. It held that LCPI's fees and expenses generally fell within the scope of its "enforcement" or "preservation" of its rights under the agreement. The court further noted the expansive scope of the attorneys' fee provision in section 9.5(b) of the agreement:

> In any event, the Court concludes that the plain language of § 9.5(b), even "narrowly construed," does not limit LCPI's entitlement to reimbursement of its fees and expenses to situations in which it was not in default. The fee-shifting provision is certainly highly skewed to favor LCPI. It encompasses actions both offensive (enforcement) and defensive (preservation). It is not mutual. It is not even dependent upon LCPI prevailing in litigation. And while the provision may not seem fair or equitable in this situation, the Court cannot impose restrictions on LCPI's entitlement to fees that are not set forth in the [agreement].[12]

3 *Friedland v. Argentor Holding Corp.*, 211 N.Y.S. 896, 898 (App. Div., 1st Dep't, 1925), *aff'd*, 242 N.Y. 532 (1926).

4 *Latshaw*, 481 B.R. at 779 ("The Court has never seen any evidence ... that Latshaw lacked the means to repay LCPI. Rather than negotiating minor concessions to compensate Latshaw for LCPI's admitted default at the time that LCPI sought a release of its unfunded commitment ... LCPI made the strategic decision to search for nonfinancial defaults as leverage ... then attempted to extort another round of transaction fees and increased interest on funds [that] Latshaw had already borrowed and was faithfully repaying.").

5 *Id.* at 776.

6 *Id.* at 776-77.

7 *Id.* at 778-79.

8 *Id.* at 779.

9 *Id.*

10 *Id.* at 795.

11 *Id.*

12 *Id.* at 797.

Observations

The *Latshaw* opinion should be encouraging to majority lenders and of concern to borrowers, but most importantly, it should be eye-opening to minority lenders under syndicated credit agreements. In *Latshaw*, the majority lender and administrative agent forced a financially healthy borrower into bankruptcy for the sole purpose of evading its funding commitment under the credit agreement, while the minority lender satisfied its own ratable portion of the commitment. Not only was the majority lender able to unburden itself of its contractual obligation, but the borrower was required to finance the majority lender's costs and legal expenses.

Like so many other credit agreements, the contract in *Latshaw* permitted the administrative agent to declare a default with the consent of the "required lenders," a numerical standard that LCPI satisfied by itself. Required lenders have the ability to direct the agent to declare the borrower to be in default, and take actions to enforce the syndicate's rights upon such default. However, a majority lender that has defaulted, or is about to default, on its own commitment has an agenda that is materially different from that of a financially sound minority lender. The majority lender benefits if the borrower gets put into bankruptcy so that it does not have to advance funds, while the minority lender benefits from receiving regular payments over the life of the loan. To the extent that the cost of putting the borrower into bankruptcy to save its own hide was an impediment to majority lenders contemplating such a course of action, after *Latshaw* that no longer seems to be a great impediment. This should be a concern for minority lenders, who in the future should seek a provision in their credit agreements that strips the administrative agent of voting and decision-making authority if it has breached its obligation to provide funding to the borrower. abi

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