

THE ARROW

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INQUIRING MINDS WANT TO KNOW:

When Can Interest and Attorney Fees Be Recovered From a Bankrupt?

Clients frequently inquire about the recovery of interest and attorney fees in bankruptcy, and we hope that this article will address these concerns as comprehensively as space permits and as clearly as words can relate.

If your debtor files bankruptcy and you have collateral securing his obligation to you, you may or may not be able to recover post-petition interest on your claim. It depends upon the value of your collateral and the terms of the contract on which the debt is based. If you are undercollateralized, you are actually the holder of two claims: a secured claim for the full value of your collateral, and a general, unsecured claim for the remaining amount of the indebtedness.

In such a situation, you may not recover interest. You are entitled to recover at least the value of your collateral and may receive a distribution on the remaining unsecured claim. In computing your balance, you should only include interest up to the petition date in your Proof of Claim. That is, interest stops running as of the petition date on an unsecured or under-

secured claim. If the value of your collateral is greater than the value of your claim, however, then you are entitled to additional interest accruing post-petition. This only makes sense since upon liquidation of your collateral, its excess value will cover the interest.

The same rule applies as to attorney fees. Of course, you must first be entitled to the recovery of attorney fees but for the bankruptcy — that is, you must have a contract or a statute providing for the payment of attorney fees by the debtor on the obligation, and the fees you request must actually be paid by you, or be the amount you have at least agreed to pay your counsel. If the value of your collateral upon liquidation is then sufficient to cover the fees you have had to pay your lawyer, then you are entitled to recovery of those fees in the bankruptcy.

If you have no collateral at all, then interest clearly stops at the petition date and your proof of claim should be filed accordingly. On the line marked "Total Amount Claimed" on the proof of claim form furnished by the bankruptcy court in such a case, you might fill in

"\$3,600.00 in principal and \$511.00 in accrued interest as of _____" [the petition date]. That way the trustee in bankruptcy will have no problem understanding your proof of claim nor in computing any pro rata dividend to which you may be entitled in the event of a distribution.

Finally, let us consider a somewhat unusual situation involving the collection of interest in bankruptcy. Suppose that the debtor is solvent at the time of filing its Chapter 11 petition—that is, the value of the debtor's assets actually exceeds its indebtedness. Should not a general, unsecured creditor be entitled to interest on its balance during the course of the reorganization effort?

Sadly, such is not the case. By definition, a general, unsecured claim, in order to be allowed by the bankruptcy court, cannot include interest from the petition date. The solvent Chapter 11 debtor must, however, pay interest on such an allowed claim from the date of the confirmation of its Plan until the final payment under the Plan.

You may never see such a situation because solvent Chapter 11 debtors are rare. But if you ever do see such a case, you are unlikely to forget it, because the inability to claim interest in a solvent estate pre-confirmation is not likely to strike you as fair and equitable.

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