

Secured Lenders Beware: Delaware Bankruptcy Court Holds Fee Cap Unenforceable

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The influential Delaware bankruptcy court issued a recent decision that all secured lenders need to be aware of. In this decision, the bankruptcy court held that the fees of the official creditors' committee were not limited by the dollar-amount cap in the financing order because the debtors confirmed their chapter 11 plan. The creditors' committee argued that it was entitled to over \$8 million in fees while the secured lender asserted that the committee's fees were capped at \$250,000 due to what the bankruptcy court referred to as a "standard carve-out provision" in the financing order. The bankruptcy court sided with the creditors' committee because it found that the carve-out provision applied only in the event of failure and became irrelevant upon confirmation of the debtor's chapter 11 plan. This decision demonstrates that the term "carve-out" is subject to differing interpretations despite its frequent use in bankruptcy parlance.

The bankruptcy court explained that carve-out provisions are included in financing orders because in every case there is uncertainty that the bankruptcy estate will have sufficient unencumbered property to pay the claims of professionals in full or to successfully confirm a chapter 11 plan. To deal with this risk, professionals usually negotiate a carve-out to allow affected professionals to look to the secured creditor's collateral for payment where otherwise, in the event of failure, they would not be able to do so unless the secured creditor first is paid in full from its collateral. The carve-out is essentially an agreement by the secured creditor to subordinate its liens and claims to the fees of certain professionals which has the effect of permitting those fees to come first in terms of payment from the bankruptcy estate's assets. The carve-out may be subject to a dollar-amount cap and also restrictions on the services that can be paid out of the carve-out.

The court held that dollar-amount caps in a carve-out provision cannot be enforced, however, if the debtor confirms a bankruptcy plan. Under the Bankruptcy Code, a debtor must pay all allowed professional fee claims in cash and in full in order to confirm a bankruptcy plan. In this respect, a dollar-amount cap in a carve-out provision only comes into play if the debtor fails to confirm a bankruptcy plan. Otherwise, a debtor must comply with the normal confirmation requirement of payment in full.

The first reaction of many secured lenders will be to draft around this decision by including different language in carve-out provisions. Anticipating this, the bankruptcy court hinted that it may not approve financing orders with absolute dollar-amount caps on fees. The bankruptcy court concluded its opinion by reducing the committee's \$8 million fee request by just \$31,000.

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