

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF)
)
LEFFERT DAIRY LLC,) CASE NO. 04-33341 HCD
) CHAPTER 11
)
DEBTOR.)

Appearances:

Mark E. Wagner, Esq., attorney for debtor, Kizer & Neu, LLP, 1406 West Plymouth Street, P.O. Box 158, Bremen, Indiana 46506; and

Michael S. McElwee, Esq., attorney for Standard Federal Bank, Varnum, Riddering, Schmidt & Howlett LLP, 333 Bridge Street, N.W., Suite 1700, Grand Rapids, Michigan 49504.

MEMORANDUM OF DECISION

At South Bend, Indiana, on January 20, 2006.

Before the court are the proof of claim filed by Standard Federal Bank (“Bank”), by and through its attorneys Varnum, Riddering, Schmidt & Howlett LLP (“Claim No. 12”), and the objection to that claim filed by the debtor Leffert Dairy LLC (“debtor”). The parties filed written responses, and the court conducted a hearing on December 1, 2005. It took the matter under advisement on December 5, 2005. For the reasons that follow, the court now disallows the Bank’s request for fees and costs in Claim No. 12.

Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(A), over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52, made applicable in this proceeding by Federal Rule of Bankruptcy Procedure 7052. Any

conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

Background

Leffert Dairy filed its chapter 11 petition on June 16, 2004. It filed plans of reorganization on October 15, 2004; April 20, 2005; and June 3, 2005. On July 26, 2005, the court confirmed the Debtor's Second Amended Plan of Reorganization. On August 2, 2005, the Bank filed a proof of claim for \$120,573.00 as an unsecured priority claim, seeking attorneys' fees and costs pursuant to 11 U.S.C. § 506(b). *See* Claim No. 12. Michael S. McElwee, Esq., of Varnum, Riddering, Schmidt & Howlett LLP, and other attorneys in his law firm represent the Bank, a secured creditor in this chapter 11 case. Claim No. 12 includes the expenses and attorneys' fees of the Bank's attorneys and the fees of John Roach, the Bank's farm consultant. *See id.* at 2.

On August 28, 2005, the debtor filed an Objection to Claim. *See* R. 149. It asked the court to disallow Claim 12 because the debtor was not able to determine if the unitemized claim was reasonable. The Bank responded that the consultant's and attorneys' fees and costs were reasonable and necessary expenses for a debtor with "a loan balance of more than \$2,000,000, and live animal collateral valued at over \$1,000,000." R. 154 at 3. It stated that the debtor's counsel had been notified of the approximate amount of the fees (in the range of \$100,000) and that the debtor had agreed to pay the fees in order to overcome the Bank's objection to confirmation. *Id.* The Bank attached to the Response the invoices, which described the legal services rendered by Mr. McElwee and his law firm and the consulting services of Mr. Roach.

On October 22, 2005, the debtor filed a "Memorandum/Explanation of Objections to the Professional Fees Claimed by Standard Federal Bank." *See* R. 170. It noted, from its review of the invoices, specific undocumented payments, insufficient itemization, possible double billing by attorneys performing the same work, and possible billing at the full rate for travel time. The debtor also questioned the Bank's use of a law firm and a consultant whose offices were distant from the debtor's operation. It even asked why Mr. Roach's consulting

services had been necessary and, if they were required, why a local consultant was not chosen. It criticized the farm consultant's billing of travel time and mileage charges, as well. The debtor urged the court to find those fees and costs unreasonable.

In its Response to the memorandum, on November 21, 2005, the Bank asked the court to reject the debtor's objections to the Bank's fee claim because (1) the debtor had agreed to the fees in open court; (2) the underlying loan documents between the Bank and the debtor require the payment of the fees; (3) 11 U.S.C. § 506(b) requires the payment of the fees of fully secured creditors like the Bank; and (4) the fees and costs are reasonable in light of the amount in controversy and the results achieved. *See* R. 180 at 1. The Bank pointed out that, under the debtor's Plan, the Bank's filing of a proof of claim would trigger its "right to recover such loan expenses [including attorneys' fees] from the Debtor." *Id.* at 2 (quoting *Second Amended Plan*, ¶ 3.2). It itemized the differences between the debtor's first proposed Plan and the confirmed Plan, and it reviewed the procedural history of the case to demonstrate the extensive services rendered by the Bank's counsel and farm consultant and the reasonableness of the fees they sought.

On December 1, 2005, the court conducted a hearing on the debtor's objection to Claim No. 12 filed by the Bank. Counsel for the debtor assured the court that the debtor was paying \$1,000 each month toward Claim No. 12. However, he reiterated his objection that neither the attorneys' nor the consultant's applications for compensation met the court's reasonableness standards. He pointed out, as an example, that travel costs should be billed at half the attorney's or consultant's standard rate of compensation.

Counsel representing the Bank responded that the law firm represented the Bank prior to the bankruptcy and was not appointed pursuant to § 327 of the Bankruptcy Code. According to the Bank, the law firm was entitled to its fees and expenses under 11 U.S.C. § 506(b). The Bank worked diligently with the debtor, through two amendments in its Plan of Reorganization, to make the Plan feasible. When the Bank's counsel disclosed the amount of the fees, prior to confirmation of the Plan, the debtor did not question or challenge it. Counsel insisted that his law firm did all it could to make the case as economical as possible. The attorneys even

conducted four depositions in one day, he noted. Counsel urged the court to find that the Bank's legal representatives were entitled to attorneys' fees and expenses pursuant to § 506(b). The court took the matter under advisement to determine whether Claim No. 12 should be allowed under § 506(b) and, in particular, to scrutinize the reasonableness of the requests for compensation and costs in the Claim.

Discussion

The debtor has objected to the Bank's Claim No. 12, which requested the fees and costs of the Bank's attorneys and farm consultant pursuant to 11 U.S.C. § 506(b).¹ Under § 506(b) of the Bankruptcy Code, an oversecured creditor holding an allowed secured claim is entitled to reasonable attorney fees and costs. The Code subsection provides:

(b) To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 506(b); *see also In re Terry Ltd. P'ship*, 27 F.3d 241, 244 (7th Cir.), *cert. denied sub nom. Invex Holdings, N.V. v. Equitable Life Ins. Co.*, 513 U.S. 948 (1994) (affirming creditor's award of appraisal fees and attorneys' fees under § 506(b)). "A secured creditor can obtain payment of its fees and expenses if the following factors are satisfied: (1) the creditor has an allowed secured claim; (2) the claim is oversecured; (3) the agreement between the debtor and the secured creditor provides for payment of such fees and expenses; and (4) the fees and expenses are reasonable." *In re Hedstrom Corp.*, 333 B.R. 815, 821 (Bankr. N.D. Ill. 2005); *see also In re Biazo*, 314 B.R. 451, 460 (Bankr. D. Kan. 2004) (listing § 506(b) prerequisites).

¹ The Bankruptcy Code does not provide explicit procedures for asserting a § 506(b) claim. Usually a request for fees and costs is made by motion pursuant to § 506(b) or by application under Bankruptcy Rule 2016. *See In re Biazo*, 314 B.R. 451, 458-59 (Bankr. D. Kan. 2004); *In re Tomasevik*, 275 B.R. 86, 95 n.13 (Bankr. M.D. Fla. 2001). However, the filing of a proof of claim "can be sufficient to satisfy the due process requirements of notice and an opportunity to present objections." *In re Biazo*, 314 B.R. at 459 (citing cases). This court will allow the proof of claim to serve as the Bank's request for fees and expenses. *See Atwood v. Chase Manhattan Mtg. Co. (In re Atwood)*, 293 B.R. 227, 231-32 (9th Cir. B.A.P. 2003).

The debtor has challenged only the fourth factor, the reasonableness of the Bank's fees and costs. The parties focused on this criterion in their briefs and at trial, and did not address the other factors. The court, however, considered the Bank's claim under all the statutory requirements. From its review of the record, the court accepts the Bank's statements that it has an allowed secured claim² (factor 1) and that the underlying loan documents between the debtor and the Bank provided for the payment of fees and expenses (factor 3). *See* R. 180 at 1. However, the court questions the Bank's assertion that it "is a fully-secured creditor under the Debtor's Plan, which means that such fees 'shall be allowed' under § 506(b)." *Id.* In the view of the court, the Bank has failed to demonstrate the second prerequisite, that it is an oversecured creditor, and the fourth prerequisite, that the claimed fees and expenses are reasonable. The court analyzes § 506(b)'s second and fourth factors below.³

Factor (2): Is the Bank's claim oversecured?

Under § 506(b), the bankruptcy court may award fees and expenses for legal services to a creditor holding an oversecured claim, which is "any claim that is for an amount less than the value of the property securing it." *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 239, 109 S. Ct. 1026, 1029, 103 L.Ed.2d 290 (1989). As the Supreme Court explained the concept in *Ron Pair*, a \$50,000 claim that is secured by a lien on property having a value of \$75,000 is an oversecured claim. *See id.* In contrast, a \$75,000 claim that is secured

² Because the Bank's claim was scheduled by the debtor, the Bank was not required to file a proof of claim. *See* Fed. R. Bankr. P. 3003(c)(2).

³ The court also has considered the Bank's argument that, because debtor's counsel originally agreed to pay everything the Bank requested, the debtor's objection to Claim No. 12 was barred by the doctrine of judicial estoppel. R. 180 at 3. The court finds, however, that the doctrine of judicial estoppel is not applicable in this case. Although it is an equitable doctrine intended "to protect the integrity of the judicial process . . . by prohibiting parties from deliberately changing positions according to the exigencies of the moment," *see New Hampshire v. Maine*, 532 U.S. 742, 750, 121 S. Ct. 1808, 1814, 149 L.Ed.2d 968 (2001), it is used specifically "to prevent a party that prevails in one lawsuit on one ground from repudiating that same ground in another lawsuit." *Jarrard v. CDI Telecomms., Inc.*, 408 F.3d 905, 914 (7th Cir. 2005) (citing cases). Judicial estoppel therefore "prevents a party from adopting a position in a legal proceeding contrary to a position successfully argued in an earlier legal proceeding." *Johnson v. ExxonMobil Corp.*, 426 F.3d 887, 891 (7th Cir. 2005). In this case, there are not two different lawsuits; the debtor did not prevail in one lawsuit on the basis of its earlier position and then take a new position inconsistent with its earlier one in a later proceeding. For that reason, the doctrine of judicial estoppel does not apply in this case.

by a lien on property having a value of \$50,000 is an undersecured claim, because the amount of the claim exceeds the value of the collateral. Section 506(b) applies to oversecured creditors and not to undersecured creditors. A creditor holding an undersecured claim is secured only to the extent of the value of the collateral. *See* § 506(a). An oversecured creditor, on the other hand, is “entitled to add postpetition interest, together with allowed postpetition fees, costs and charges to the allowed amount of its claim, limited only to the extent of the oversecurity.” 4 *Collier on Bankruptcy* ¶ 506.04[1] at 506-104 (Alan N. Resnick & Henry J. Sommer, eds.-in-chief, 15th ed. rev’d 2005). To be entitled to reasonable attorney fees and costs, the creditor bears the ultimate burden of proving, by a preponderance of the evidence, “that its claim was oversecured, to what extent, and for what period of time.” *Heritage Bank Tinley Park v. Steinberg (In re Grabill Corp.)*, 121 B.R. 983, 992 (Bankr. N.D. Ill. 1990); *see also In re Biazio*, 314 B.R. at 460-61.

Under § 506(b), the holder of the claim is the creditor, not the creditor’s attorney. *See In re CVC, Inc.*, 120 B.R. 877, 880 (Bankr. N.D. Ohio 1990). In this case, the Bank holds a claim against the debtor that arises from the debtor’s obligation to the Bank and that is secured by the debtor’s dairy operation. The Bank did not file a proof of claim based on the amounts loaned to the debtor over time. Its Claim No. 12 listed only the fees and expenses it sought in reimbursement for the legal representation and consulting it received.

Because the Bank did not proffer evidence of the amount of its secured claim or the value of the property securing it, the court examined the record to make those determinations. On the debtor’s schedules, the Bank was listed on Schedule D as a secured creditor with a claim of \$2,052,500.51, of which \$1,212,025.51 was unsecured. *See* R.1, Sch. D. The Schedule stated that the claim was secured by a lien on the debtor’s dairy operation, the assets of which were valued at \$840,475.00. *Id.* In the debtor’s confirmed Plan, the debtor agreed to pay the Bank \$1,900,000.00. *See* R. 121, ¶ 3.2. At trial, the Bank pointed out that Leffert Dairy’s debts to the Bank amounted to \$2.1 million and that its collateral, the live animals, was valued at more than \$1 million. Even though the value of the dairy herd may have increased from the amount indicated in the debtor’s schedules, the court notes that the Bank did not provide documentary evidence of its value. *See Financial Sec. Assurance Inc.*

v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship), 116 F.3d 790, 798 (5th Cir. 1997) (citing *In re Grabill Corp.*, 121 B.R. at 991-92)). Nor did the Bank proffer mortgage documents or evidence of the value of other collateral securing its claim. In fact, the Bank's claim itself is variably valued at \$1.9 million, \$2.052 million, or \$2.1 million.

In the view of the court, the record clearly shows that the value of the collateral securing the Bank's claim (whether the value of the dairy operation is \$840,475.00 or \$1 million) does not exceed the value of the debtor's obligation to the Bank and therefore that the Bank is undersecured. The Bank has not presented any evidence to establish that its claim was oversecured. It thus has not satisfied that requirement of § 506(b). See *In re Biazio*, 314 B.R. at 461 (finding that the claimant does not qualify for fees under § 506(b)); *In re Grabill Corp.*, 121 B.R. at 992 (finding that the Bank had not demonstrated the amount by which it was oversecured, denying summary judgment); *In re CVC, Inc.*, 120 B.R. at 880-81 (disallowing counsel's claim because of lack of documentation of creditor's oversecured claim).

Nevertheless, the Bank correctly pointed out that the debtor awarded the Bank its fees and expenses in the confirmed Second Amended Plan of Reorganization. The Bank asserts that it is a fully secured creditor under the Plan. See R. 180 at 1. The pertinent provision, ¶ 3.2 of the Plan, states:

3.2 Class 2 Claim: Debtor shall pay Standard Federal Bank approximately the sum of \$1,900,000.00 or the amount of said debtor's [*sic*] amended and allowed secured claim filed after confirmation of this plan along with interest of 7.75% per annum in monthly installments of \$15,000.00 starting with the effective date of the plan continuing each month thereafter until six (6) years from the effective date of the plan at which point any remaining balance due this creditor shall be paid in full. In addition, debtor shall pay to this creditor at the rate of \$1,000.00 per month any amount that the Court might allow as to such creditor's loan expenses such as attorney fees, etc. along with 7.75% interest which payments shall start with the effective date of the plan and continuing each month thereafter until paid or until six (6) years from the effective date of the plan at which point any remaining balance due on this account shall be paid in full. Such creditor shall file their claim for such loan expenses within sixty (60) days of when this plan might be confirmed by the court or the right to recover such loan expenses from the debtor shall lapse hereunder.

R. 121 , Second Amended Plan of Reorganization, Art. III, ¶ 3.2. Notably, the Plan provision does not identify the Bank as fully secured or oversecured. Nevertheless, it treats the Bank as oversecured by agreeing to pay the

Bank \$1.9 million (or the amount of an allowed secured claim filed postconfirmation) plus its “loan expenses,” if the Bank files its claim within 60 days of Plan confirmation.⁴ The Plan clearly states, however, that the debtor will pay “any amount that the Court might allow as to the creditor’s loan expenses such as attorney fees.” *Id.*

The court allows the Bank’s request for “loan expenses” only if it is allowed under § 506(b). A claim for fees and costs is included as part of the creditor’s claim to the extent that the creditor is oversecured and therefore has a “security cushion.” The authoritative treatise *Collier on Bankruptcy* explained:

If the claim for attorney’s fees is valid under applicable state law, then the claim must be allowed under section 502, and included as part of the creditor’s oversecured claim (*to the extent of the oversecurity*), provided that the amount included as part of the creditor’s oversecured claim is reasonable. Any amount not included as part of the creditor’s oversecured claim would constitute an unsecured claim.

⁴ *Collier on Bankruptcy* ¶ 506.04[3][a] at 506-115 (emphasis added). For that reason, the court allows reasonable fees and expenses to be recovered only to the extent that the Bank is oversecured. *See In re Plymouth House Health Care Center*, ___ B.R. ___, 2005 WL 2589201 at *5 (Bankr. E.D. Pa. Sept. 14, 2005) (citing cases). Because the record before the court indicates that the Bank is an undersecured creditor whose collateral is worth less than the debtor’s obligation, it cannot avail itself of § 506(b) in support of its fee request. Having failed to demonstrate by a preponderance of the evidence that its claim is oversecured, the Bank is not entitled to reimbursement of reasonable attorney’s fees, costs or charges as provided under § 506(b). Accordingly, the Bank’s Claim No. 12, sought pursuant to § 506(b), is disallowed.

Factor 4: Are the fees and expenses reasonable?

Having found that the Bank has not proven that it is an oversecured creditor, “the inquiry ends.” *In re Farmers Co-op Ass’n*, 323 B.R. 494, 502 (Bankr. D. Kan. 2005). Nevertheless, because the parties focused exclusively on the fourth factor of § 506(b), the court discusses the reasonableness criterion.

⁴ The Bank filed Claim No. 12, for fees and expenses, but did not file a claim for the total amount of the debtor’s indebtedness to it.

Under § 506, the amount of fees, costs and charges the bankruptcy court may award the Bank must be reasonable. In this district, the reasonableness of those attorneys' fees "is determined by a federal standard."⁵ *In re Harper*, 146 B.R. 438, 444 (Bankr. N.D. Ind. 1992); *see also Welzel v. Advocate Realty Investments, LLC (In re Welzel)*, 275 F.3d 1308, 1314-15 (11th Cir. 2001) (citing cases). The creditor requesting the fees has the burden of proving reasonableness under § 506(b). *See In re Hedstrom*, 333 B.R. at 821. The court "has broad discretion to determine what constitutes a reasonable fee." *Id.* at 822. It may rely on the factors presented for compensation applications submitted under 11 U.S.C. § 330 and under Bankruptcy Rule 2016. *See id.*

Accordingly, this court reviewed the debtor's objections and the Bank's responses. It examined in detail the invoices submitted by the Bank's attorneys and its farm consultant. It evaluated the time spent and rates charged for services. It considered whether the services were necessary or beneficial to the case, whether they were performed within a reasonable amount of time, and whether the requested compensation was reasonable. The court limited its review, however, to the legal and consulting fees and costs incurred postpetition. *See In re Process Property Corp.*, 327 B.R. 603, 606 (Bankr. N.D. Tex. 2005) (stating that § 506(b) "applies only to postpetition accretions"); *In re 900 Corp.*, 327 B.R. 585, 593 (Bankr. N.D. Tex. 2005) (same); *In re Leatherland Corp.*, 302 B.R. 250, 257-58 (Bankr. N.D. Ohio 2003) (same).

Turning first to the invoices of Roach & Associates, LLC, the court found that Mr. Roach submitted a monthly invoice for various amounts. The description of his services was exceedingly brief and uninformative; it stated either "financial" or "business analysis." Only two invoices gave more information. The one dated January 26, 2005, sought \$5,000 for "business analysis" and added: "This invoice is to re-establish the retainer which has been depleted." On the April 29, 2005 invoice, travel time (11.5 hours at 1/2 rate) and mileage (145 mi. at .405) were charged. No explanation of the consultant's activities, time spent, or method of calculating the fees was given. No details concerning his journey of 145 miles that encompassed 11.5 hours was proffered. The

⁵ There is a split of authority concerning whether courts should apply federal law or state law. For a discussion of the question, *see 4 Collier on Bankruptcy* ¶ 506.04[3][a] at 506-114, 115.

contract between the Bank and Mr. Roach, which might have explained the retainer, charges, and expected services, was not provided. *See In re ACT Mfg., Inc.*, 281 B.R. 468, 491 (Bankr. D. Mass. 2002) (requiring consultants to explain their functions). Without any explanation of those charged amounts, either on the invoices, in the Bank's briefs, or at the hearing, the court finds that the fees and expenses of Mr. Roach are not reasonable and thus are disallowed in their entirety. *See First Bank of Ohio v. Brunswick Apts. of Trumbull Cty., Ltd. (In re Brunswick Apts. of Trumbull Cty., Ltd.)*, 169 F.3d 333, 334-35 (6th Cir. 1999) (affirming disallowance of consulting fees because, *inter alia*, time records were incomplete and inadequate); *In re Hedstrom Corp.*, 333 B.R. at 823-24 (denying consultant's application for fees because of its vague, uninformative descriptions, lumping of services, lack of records or evidence of work product).

The court then examined the Bank's invoices of legal services performed postpetition. It found that the law firm presented detailed statements of the services it rendered and the time spent. Although the debtor's challenges to the Bank's travel charges and occasional cursory itemizations are well taken, in general the court found that the descriptions were sufficiently informative. Nevertheless, because the Bank, an undersecured creditor, does not have statutory entitlement to recovery of attorney's fees under § 506(b), the court declines to determine which of the requested fees and expenses are reasonable.

In conclusion, the court finds that the Bank's request for all legal and consulting services performed before the debtor filed its bankruptcy petition on June 16, 2004, is disallowed. In addition, the fees, costs and charges of the Bank's farm consultant John Roach of Roach & Associates, LLC, are disallowed as unreasonable pursuant to § 506(b). Finally, because the Bank has failed to demonstrate that it is an oversecured creditor of the debtor, its Claim No. 12 for fees, costs and charges pursuant to § 506(b) is disallowed. The debtor's objection to the Bank's Claim No. 12 is sustained, although on alternate grounds from the ones raised by the debtor.

Conclusion

For the reasons presented above, Claim No. 12 filed by Standard Federal Bank is disallowed.

SO ORDERED.

/s/ Harry C. Dees, Jr.
HARRY C. DEES, JR., CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT