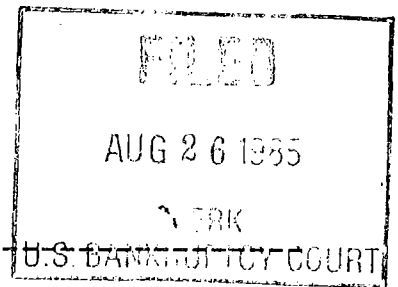


UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WISCONSIN



In re:

Case Number:

BALTZ WELL DRILLING, INC.

WF7-83-02128

Debtor.

OPINION AND ORDER DISALLOWING CLAIM

Debtor Baltz Well Drilling, Inc., filed a Reorganization Petition under Chapter 11 of the U. S. Bankruptcy Code, 11 U.S.C. § 101 et seq., on December 30, 1983. Schedule A-2 of its petition lists Credit Alliance Corporation as a secured creditor with a claim of \$19,200. On October 11, 1984, this proceeding was converted into a Chapter 7 Liquidation Proceeding.

Credit Alliance has filed a Proof of Claim in the amount of \$29,450.35 as of April 6, 1985. This claimed debt arose from a loan transaction between debtor and Credit Alliance. Credit Alliance contends that \$18,010.15 of its claim was the principal balance of the loan as of November 25, 1983. The security agreement provides for payment of late charges for delayed contractual performance of 1/15 of 1% per day. It also provides that the debtor will indemnify Credit Alliance for expenses, including reasonable attorney's fees, it may incur to enforce payment or performance. Another provision of the agreement allows Credit Alliance, upon certain stated circumstances, to take possession of and sell mortgaged property. The sale proceeds are

to first be applied to the costs of obtaining and selling the mortgaged property, including attorney's fees equal to 20% of the unpaid mortgage obligations. Based on these provisions Credit Alliance claims \$6565.97 as late charges through April 6, 1985, and \$4914.23 as attorneys' fees. The attorneys' fees constitute 20% of the unpaid indebtedness as of the Proof of Claim filing. Credit Alliance additionally seeks daily accrual on these amounts of \$14.41.

The trustee in this proceeding, Arthur L. Eberlein, has objected to the Credit Alliance claim. A hearing on this objection was duly held. Credit Alliance appeared by Attorney Daniel O. Daubert, the Trustee personally and debtor by Attorney Roger Deffner. Since the parties agreed that Credit Alliance was entitled to the principal amount of \$18,010.15, the court directed the Trustee to pay that amount to Credit Alliance. The Trustee and Credit Alliance have filed briefs with this court on the remaining issues.

The initial issue before the court is whether Credit Alliance is entitled to the contractual late charges of 1/15 of 1%. Credit Alliance maintains that this charge is allowed by 11 U.S.C. § 506(b). That section provides:

§ 506(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, 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.

Credit Alliance argues that the contractual late charges are reasonable charges within the meaning of sec. 506 and therefore allowable.

Whether the late charges of 1/15 of 1% are reasonable is a question of state law. In re LHD Realty Corporation, 20 B.R. 722 (Bankr.S.D.Ind. 1982). Numerous federal and state courts have addressed this issue. A bankruptcy court is a court of equity which will not enforce a penalty. In re Tastyeast, Inc., 126 F.2d 879, 881 (3rd Cir. 1942). Courts which have considered the enforceability of a late charge or default provision have decided whether the provision constitutes an unenforceable penalty or an enforceable liquidated damages clause. In re Tastyeast, 126 F.2d 879, 882; In re United Merchants and Manufacturers, Inc., 674 F.2d 134, 141-142 (2nd Cir. 1982).

The Wisconsin Supreme Court in McConnell v. L.C.L. Transit Co., 42 Wis. 2d 429, 167 N.W.2d 226, 230 (1969), pointed out that Wisconsin has always recognized the distinction between liquidated damages and a penalty. In a later case the Wisconsin Court of Appeals stated that a liquidated damages clause will not be enforceable unless:

- (1) the amount reasonably forecasts the amount of just compensation for the breach; and
- (2) the harm is incapable or very difficult to accurately estimate. Restatement (Second) of Contracts § 339 (1973)

United Leasing, ETC. v. R. F. Optical, Inc., 103 Wis.2d 488, 309 N.W.2d 23, 26 (1981).

Regardless of whether the second requirement has been satisfied, this late charge provision is unenforceable because it bears no similarity to a reasonable estimation of damages. A daily late charge of 1/15 of 1% is equivalent to slightly over 24% annually. Even without hindsight it must be concluded that the amount of 24% on an annual basis is clearly disproportionate to any reasonable forecast of damages at the time the loan was made. At that time the prevailing financial market could only lead one to conclude that investment return on all but the most risky ventures was considerably below 24%. This was especially true if one considered the countervailing effects of inflation.

Contract terms which establish damages in an amount clearly disproportionate to actual loss seek to deter breach through compulsion. Leasing Services Corp. v. Justice, 673 F.2d 70, 73 (2nd Cir. 1982). Because the promisor fears severe economic loss he is compelled to perform, while the promisee may gain significantly more than fair compensation. Id.

The court concludes that the provision of the security agreement between the parties providing for late fee charges of 1/15 of 1% daily is an unenforceable penalty provision. The amount of the late fee is clearly and significantly in excess of any reasonable estimate of damages.

As pointed out earlier, Credit Alliance contends that it is entitled to attorneys fees totalling 20% of the unpaid loan balance. Paragraph 3(f) of the security agreement between the parties provides that the debtor will indemnify Credit Alliance

for expenses, including reasonable attorneys' fees, which Credit Alliance may incur to enforce payment or performance. Paragraph 5 allows Credit Alliance, upon certain stated conditions, to take possession of and sell mortgaged property. The proceeds of such sale are to first be applied to the costs of obtaining and selling the mortgaged property, including attorneys fees equal to 20% of the unpaid mortgage obligations. A reasonable reading of these two provisions leads to the conclusion that the contract allows for reasonable attorneys' fees, not 20% of the due amount. Paragraph 5 is simply not applicable here since Credit Alliance has not taken possession of or sold mortgaged property. At best, from the bank's standpoint, the two provisions could be viewed as creating an ambiguity. However, because Credit Alliance drafted the security agreement any ambiguity must be construed against it. In re Kennedy Mortgage Co., 23 B.R. 466, 473 (Bankr.D.N.J. 1982). Consequently, the court determines that the security agreement allows recovery of reasonable attorneys' fees incurred in enforcing payment.

Regardless of the amount of attorney's fees provided by contract, 11 U.S.C. § 506(b) allows only reasonable fees. Several courts have indicated that a creditor is not entitled to reimbursement for services which are unnecessary. In re Continental Vending Machine Corp., 543 F.2d 986, 994 (2nd Cir. 1976); In re Minnesota Distillers, Inc., 45 B.R. 131, 135 (Bankr. D.Minn. 1984).

Credit Alliance seeks recovery of attorney's fees of \$4914.23 as of the Proof of Claim filing. That amount is equal to 20% of the unpaid indebtedness as of that date. The court concludes that Credit Alliance is not entitled to recover any attorneys' fees. Legal action by Credit Alliance has been completely unnecessary to collect its debt. The Trustee stipulated to the fact that a principal amount of \$18,010.15 was due and has paid this amount. The only dispute has been whether Credit Alliance is entitled to its contractual late charges and attorneys fees. Credit Alliance was a secured creditor. Its secured collateral sold for a net amount, after sale expenses, of over \$79,000. Further, Credit Alliance was never in danger of losing the equity that existed in its security. This is evidenced by the denial of its motion for relief from stay.

Under these circumstances the court must conclude that Credit Alliance has incurred no reasonable attorneys' fees in this action. To determine otherwise would be to force the debtor and other creditors to bear the expense of Credit Alliance's efforts to collect late charges and attorneys' fees for which there was no legal basis.

The final issue before the court is what amount of interest Credit Alliance is entitled to collect. The parties, as noted earlier, have stipulated that \$18,010.15 was the principal amount due as of November 25, 1983. The loan agreement between the parties contained a pre-computed, combined amount of principal and interest. As Credit Alliance has noted the contract

documents do not specify an interest rate. Therefore, the court determines that Credit Alliance is entitled to the legal rate of interest of 5%. Wis. Stat. § 138.04.

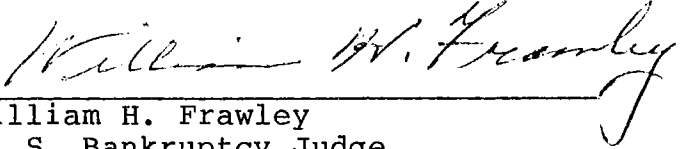
ORDER

IT IS ORDERED THAT the claim of Credit Alliance for attorney's fees and a contractual late charge is disallowed.

IT IS FURTHER ORDERED THAT Credit Alliance is entitled to 5% interest on its principal amount due of \$18,010.15, which the court earlier directed Trustee to pay.

Dated: August 26, 1985.

BY THE COURT:



William H. Frawley
U. S. Bankruptcy Judge

cc: Attorney Arthur L. Eberlein
Attorney Daniel O. Daubert
Attorney Roger Deffner