

Bankruptcy Law

Post-Petition Attorneys' Fees Stemming From a Prepetition Indemnity Agreement are 'Categorically Allowable'

By David M. Bass

Under the Bankruptcy Code, is an unsecured creditor entitled to recover post-petition attorneys' fees that were authorized by a prepetition contract but were contingent on post-petition events? That was the precise issue confronting the United States Court of Appeals for the Second Circuit in the case *Ogle v. Fid. & Deposit Co. of Md.*, 2009 WL 3645651 (2d Cir. Nov. 5, 2009). Answering the question affirmatively in its November 5, 2009, ruling, the Second Circuit expanded upon the United States Supreme Court's holding in *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007), which specifically left unresolved the issue of whether an unsecured creditor may properly include in its claim contractual attorneys' fees incurred post-petition, and became the second circuit court of appeals after *Travelers* to hold that the bankruptcy code does not bar a prepetition unsecured claim for post-petition attorneys' fees provided for in a prepetition contract that is valid under state law.

Bass is a member of Cole Schotz Meisel Forman & Leonard in New York and concentrates his practice in bankruptcy and restructuring, insolvency and creditors' rights, and related litigation.

In *Ogle*, Fidelity & Deposit Company of Maryland entered into several prepetition agreements with Agway, Inc. pursuant to which Fidelity provided surety bonds to Agway's insurers, and which required Agway to indemnify Fidelity for any payments it made under the bonds as well as for attorneys' fees that Fidelity might incur to enforce the prepetition agreements against Agway. As of Agway's Chapter 11 filing, Agway had not defaulted on any payment obligation to its insurers and, thus, Fidelity had no more than a contingent right to payment under the prepetition agreements.

After Agway filed for bankruptcy, it defaulted on payments to its insurers, who, in turn, sought payment from Fidelity. Fidelity duly made payments to the insurers consistent with its obligations under the surety bonds, then unsuccessfully demanded indemnity under the agreements, and incurred attorneys' fees in litigation to collect from Agway. The liquidating trustee of the Agway Liquidating Trust (the "Liquidating Trustee") conceded that Fidelity had a right to the fees under state contract law, but refused to pay or allow a claim for such fees, asserting that the Bankruptcy Code barred such recovery.

The United States Bankruptcy Court for the Northern District of New York held that Fidelity was entitled to assert, as part

of its unsecured claim, post-petition attorneys' fees of \$884,506.28. The United States District Court for the Northern District of New York affirmed and the liquidating trustee appealed to the Second Circuit.

The Second Circuit framed the "sole question" on appeal as one of law: "Under the Bankruptcy Code, is an unsecured creditor entitled to recover post-petition attorneys' fees that were authorized by a prepetition contract but were contingent on post-petition events?"

After acknowledging that courts are "closely divided" on the question presented, the Second Circuit joined the Ninth Circuit's recent decision in *Centre Ins. Co. v. SNTL Corp. (In re SNTL)*, 571 F.3d 826 (9th Cir. 2009), answering the question left open by *Travelers*, i.e., whether such claims are allowable categorically, and held that "the Bankruptcy Code does not bar an unsecured claim for post-petition attorneys' fees authorized by a prepetition contract valid under state law."

Recognizing that it previously found such fees are allowable under the former Bankruptcy Act (the predecessor to the current Bankruptcy Code) in *United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc'y of the U.S.*, 674 F.2d 134, 137-39 (2d Cir. 1982), the Second Circuit concluded that if its holding in *United Merchants* survived the statutory revision

to the bankruptcy laws and the Supreme Court's holding in *Travelers*, it would be dispositive of the issues on appeal in *Ogle*.

The Second Circuit began its analysis with the two governing Bankruptcy Code provisions, Sections 502(b) and 506(b). Section 502(b) provides that a bankruptcy court "shall determine the amount of [a] claim ... as of the date of the filing of the petition ..." The liquidating trustee argued that under Section 502(b), Fidelity was limited to a claim for prepetition fees because post-petition fees could not, by definition, be fixed as of the petition date.

Although *Travelers* did not resolve this issue expressly, the Second Circuit found support for its conclusion from the Supreme Court's opinion and rejected the liquidating trustee's argument:

All of the fees at issue in *Travelers* were incurred post-petition; so the amount was necessarily unknown when the bankruptcy petition was filed. It follows that if an unsecured claim for post-petition fees was for that reason unrecoverable, the *Travelers* Court could have disposed of the claim on that simple, available ground alone. *Travelers*, therefore, proceeds along lines that, reasonably extended, would suggest (notwithstanding the Court's express disclaimer) that section 502(b)'s requirement — that the court "shall determine the amount of such claim ... as of the date of the filing of the petition" — does not bar recovery of post-petition attorneys' fees.

Accordingly, the Second Circuit held that an unsecured claim for post-petition fees, authorized by a valid prepetition contract, is allowable under section 502(b) and is deemed to have arisen prepetition.

The Second Circuit next turned to the liquidating trustee's argument that Section 506(b) expressly disallowed the recovery of attorneys' fees as part of an unsecured claim, i.e., that under Section 506(b), only oversecured creditors can seek to recover for post-petition fees. Analyzing *Travelers* and current statutory law (to determine whether the holding in *United Merchants* survived), the Second Circuit concluded as follows:

As *Travelers* makes clear, the question is whether the Code disallows post-petition attorneys' fees, and does so expressly. It was therefore decisive in *Travelers* that "the Code says nothing about unsecured claims for contractual attorney's fees incurred while litigating issues of bankruptcy law." And while *Travelers* declined to address section 506(b) (because the parties had not raised the issue below), see *id.* at 454-56, it is decisive here that the Code says nothing about such fees incurred litigating things other than issues of bankruptcy law. The teaching of *Travelers* is therefore fully consonant with our decision in *United Merchants*.

Accordingly, the Second Circuit held that section 506(b) of the Bankruptcy Code does not implicate unsecured claims for post-petition attorneys' fees and therefore, imposes no bar to recovery.

The liquidating trustee also asserted three additional reasons why the Bankruptcy Code prevented the allowance of such fees: (i) that the Supreme Court's "general rule" expressed in *United Sav. Assoc. of Tex v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988), addressing the issue of the disallowance of unmatured interest in Section 502(b)(2) similarly would result in a disallowance of attorneys' fees; (ii) that Section 502(e)(2) implicitly creates an exception to post-petition attorneys' fees; and (iii) that public policy requires such disallowance. The Second Circuit swiftly rejected each of these additional arguments.

Thus, while *Travelers* reserved decision on whether an unsecured creditor categorically can recover post-petition attorneys' fees that are authorized by a prepetition contract, it is now clear, at least in the Second Circuit, that such claims, to the extent valid under state law (and not otherwise subject to any of the Section 502(b)(2)-(9) exceptions), are allowable.

With the Second Circuit's decision in *Ogle* (and the prior decision from the Ninth Circuit in *SNTL*), there are now two circuit court of appeals decisions recognizing the availability of post-petition attorneys' fees to unsecured creditors. The impact of *Ogle* should be considered carefully by debtors and unsecured creditors' lawyers when litigating issues with respect to prepetition contracts that have legal fees' provisions. ■