

Post-Bankruptcy Legal Fees

Second Circuit Joins Ninth Circuit in Allowing Fees Based on Pre-Bankruptcy Agreement

By Michael L. Cook

The United States Court of Appeals for the Second Circuit held on Nov. 5, 2009, that a creditor was entitled to its post-bankruptcy legal fees incurred under a pre-bankruptcy indemnity agreement. *Ogle v. Fid. & Deposit Co. of Md.*, ___F.3d ___, 2009 U.S. App. LEXIS 24329 (2d Cir. Nov. 5, 2009). Affirming the lower courts and agreeing with a recent Ninth Circuit decision, the Second Circuit explained that the Bankruptcy Code ("Code") "interposes no bar ... to recovery." *Id.* at *12 (citing *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 452 (2007) ("[C]laims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed.")).

RELEVANCE

Lenders, financial advisers, accountants, indenture trustees and other professionals who bargain for reimbursement of their legal fees should be reassured by *Ogle*. Lower courts in the Second Circuit and elsewhere had previously disallowed creditors' professional fees, wrongly holding that: 1) nothing in the Code authorizes the payment of these fees; and that 2) contractual rights to these fees are unenforceable. See, e.g., *J.P. Morgan Trust Co., N.A. v. A.P. Green Indus., Inc.*, No. 06-0885, slip

op. at 4 (W.D. Pa. Nov. 5, 2007) (affirmed bankruptcy court's denial of indenture trustee's reimbursement claim for legal fees; "Under the maxim of *expressio unius est exclusio alterius* (the expression of one is the exclusion of the alternatives), silence as to undersecured claims for attorneys' fees and costs in [Code] § 506(b) indicates that they are excluded from payment."; a case the author succeeded in losing, *In re Crafts Retail Holding Corp.*, 378 B.R. 44, 50 (Bankr. E.D.N.Y. 2007) ("[A]bsent statutory authority, [financial adviser's] claimed contractual rights or asserted principles of equity alone do not constitute cognizable bases for an award of compensation or reimbursement of expenses in bankruptcy cases."). According to the Second Circuit, the appellate courts have been "closely divided on the" issue of post-bankruptcy fees. *Ogle* at *7. Compare *In re SNTL Corp.*, 571 F.3d 826, 839-45 (9th Cir. 2009) (allowing unsecured guarantor's reimbursement claim for post-petition attorneys' fees based on pre-petition contract); *Martin v. Bank of Germantown*, 761 F.2d 1163, 1168 (6th Cir. 1985) ("... creditors are entitled to recover attorneys' fees in bankruptcy claims if they have a contractual right to them valid under state law ..."; collection costs and legal fees in lender's note); *In re Shangra-La, Inc.*, 167 F.3d 843, 848-49 (4th Cir. 1999) ("Entitlement to attorneys' fees ... depended on ... terms of [contract] and on state law."), with *Adams v. Zimmerman*, 73 F.3d 1164,

1177 (1st Cir. 1996) (disallowing claim for post-insolvency fees against FDIC receiver; non-bankruptcy case), and *In re Waterman*, 248 B.R. 567, 573 (B.A.P. 8th Cir. 2000) (allowing claim for post-petition fees under Code § 506(b) only because creditor was oversecured).

FACTS

In *Ogle*, the contractual entitlement to attorneys' fees arose from a series of pre-bankruptcy agreements between Fidelity and Agway. In exchange for Fidelity's providing surety bonds to Agway's insurers, Agway agreed to indemnify Fidelity for any payments made under the bonds plus any legal fees incurred enforcing the agreements. *Ogle*, 2009 U.S. App. LEXIS 24329, at *4. After filing its Chapter 11 petition, Agway defaulted on its obligations to the insurers. Fidelity complied with its obligation under the bonds, and tendered payment to Agway's insurers. Fidelity's efforts to enforce its indemnity rights against Agway, however, resulted in protracted litigation during which Fidelity incurred costs, including attorneys' fees. *Id.* The Agway liquidating trustee conceded that Fidelity was entitled to the fees under state contract law, but argued that the Code barred Fidelity's recovery. *Id.* The Second Circuit considered the following narrow issue: "Under the Bankruptcy Code, is an unsecured creditor entitled to recover post-petition attorneys' fees that were authorized by a pre-petition contract but were contingent on post-petition events?" *Id.* at *5-*6.

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ASSERTEDLY RELEVANT CODE PROVISIONS

Code § 502(b): Right To Payment.

The court first rejected the trustee's argument that Code § 502(b) precluded the legal fees sought by Fidelity. Quoting the Supreme Court in *Travelers*, the court noted that the Code defines "claim" to be a "right to payment," which "usually refer[s] to a right to payment recognized under state law." *Id.* at *8 (*Travelers*, 549 U.S. at 451) (internal quotation marks omitted).

Contingent Claims Allowable. That the creditor's claim here was contingent was also unimportant. As the court explained, the Code § 101(5) (A) includes "contingent" claims in its definition of "claim." *Id.* Because applicable state contract law gave the creditor here a right to payment when the indemnification agreement was signed, the creditor "possessed a contingent right to post-petition attorneys' fees," although "its right arose pre-petition." *Id.* at *9. Moreover nothing in Code § 502(b) precludes an unsecured creditor's "recovery of post-petition attorneys' fees" because the claim was contingent. *Id.* at *9-*10. Accord, *In re SNTL Corp.*, 571 F.3d 826, 838 (9th Cir. 2009) ("Under section 502(b)(1), those contingent claims cannot be disallowed simply because the contingency occurred postpetition Contingent claims are allowed under Section 502(b)"). In the Second Circuit's reading of the Supreme Court's *Travelers* opinion, it had to "presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed." 2009 U.S. App. LEXIS 24329, at *15.

INAPPLICABILITY OF CODE EXCEPTIONS TO ALLOWABILITY

Moreover, none of the exceptions to the allowability of a claim listed in § 502(b) applied to the claim here. Although § 502(b)(1) makes any defense

to a claim available to a bankruptcy trustee, unless applicable state law or one of the exceptions in § 502(b) applies, "the claim must be allowed." *Id.* at *9-*10 (quoting *Travelers*, 549 U.S. at 452).

The court's reasoning is straightforward:

The underlying contract is valid as a matter of state substantive law; none of the § 502(b)(2)-(9) exceptions apply; and the Code is silent as to the particular question presented ... whether the Code allows unsecured claims for fees incurred while litigating issues of contract law more generally.

Id. at *11-*12 (internal quotation marks omitted).

Code § 506(b) Not Applicable. The court also rejected the trustee's reliance on Code § 506(b), which only bars interest on an undersecured creditor's claim. Because Code § 506(b) "does not implicate unsecured claims for post-petition attorneys' fees," reasoned the court, it thus "interposes no bar to recovery." *Id.* at *13. Accord, *In re SNTL Corp.*, 571 F.3d at 841 ("... we reject the argument that section 506(b) preempts postpetition attorneys' fees for all except oversecured creditors."), citing *In re 268 Ltd.*, 789 F.2d 674,678 (9th Cir. 1986) (§ 506(b) does not "limit the fees available" as an unsecured claim but merely "define[s] the portion of the fees [to] be afforded secured status,"); *In re Welzel*, 275 F.3d 1308, 1316-20 (11th Cir. 2001) (§ 502(b) "does not ... disallow attorneys' fees of creditors ...").

Nor does the Supreme Court's holding in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) (held, § 506(b) permitted post-bankruptcy interest to be paid only from equity cushion; undersecured creditor could not get post-bankruptcy interest) mandate disallowance of unsecured claims for post-bankruptcy legal fees. Although §

502(b)(2) "specifically disallows claims for unmatured interest," § 502(b) "does not contain a similar prohibition against attorneys' fees." *SNTL Corp.*, 571 F.3d at 844. As the Second Circuit noted in *Ogle*, "while section 502(b) (2) bars claims for unmatured interest, it does not similarly bar (or even reference) claims for post-petition attorneys' fees." 2009 U.S. App. LEXIS 24329, at *14-*15.

POLICY ARGUMENT

Finally, the court rejected the trustee's policy argument that allowance of the fees here would "unfairly disadvantage other creditors ... whose distributions would be reduced." *Id.* at *15. Here, sophisticated parties negotiated an agreement with a provision for the recovery of legal fees. The creditor will not be receiving an undeserved bonus at the expense of others. Allowance of the claim "merely effectuates the bargained-for terms of the [pre-bankruptcy] loan contract." *Id.* at *16 (quoting *In re United Merchants & Mfrs., Inc.*, 674 F.2d 134, 137 (2d Cir. 1982) (pre-Code case)). See *SNTL Corp.*, 571 F.3d at 845 ("... the Bankruptcy Code itself [does] not specifically disallow ... postpetition fees In the end, it is the province of Congress to correct statutory dysfunctions and to resolve difficult policy questions embedded in the statute.").

HOW OTHER COURTS HAVE STRUGGLED

Some lower courts have simply ignored the Supreme Court's March 20, 2009 *Travelers* decision. See, e.g., *A.P. Green Industries, supra* (Section 506(b), dealing with a secured creditors' claim for legal fees, "controls over the general statute, section 502(a)"; secured creditors "are able to collect [legal fees] only to the extent that there is a security cushion from which they can be paid"; "to allow

contractual claims for attorneys' fees ... would impair the debtor's fresh start ... while treating similarly situated creditors differently."). Another court asserted, despite the *Travelers* holding, that it had never approved a pre-bankruptcy contractual legal fee reimbursement clause and that, in any event, the clause "was not in compliance with federal bankruptcy law, *i.e.*, [Code] §§ 327 and 330." *Crafts Retail*, 378 B.R. at 51 (relying on *In re United Merchants & Manufacturers, Inc.*, 597 F.2d 348 (2d Cir. 1979) (denying legal fees to indenture trustee), but ignoring *In re United Merchants & Manufacturers, Inc.*, 674 F.2d 134, 138-39 (2d Cir. 1982) (" ... we find no law or policy that supports the ... disallowance of ... claims ... for collection costs under ... the loan agreements"; distinguished compensation for expenses in administering estate from "claims [that] are part of the contractual indebtedness [to creditors], and [thus] not subject to the statutory limitations on reimbursement for expenses of administering the estate.").

The bankruptcy court in *Crafts Retail* also stressed the lack of an express Code provision authorizing the reimbursement of a financial advisor's pre-bankruptcy contractual claim for post-bankruptcy legal fees. 378 B.R. at 44. In its view, the "morphing of attorney compensation into a garden variety expense item is unacceptable" *Id.* Other bankruptcy courts reached similar conclusions. *In re Elec. Mach. Enter., Inc.*, 371 B.R. 549, 551-52 (Bankr. M.D. Fla. 2007) (stating that Supreme Court in *Travelers* "declined to express an opinion on whether unsecured creditors are entitled to post-petition attorneys' fees"; "plain language" of § 506(b) precludes claims); *In re Pride Cos., L.P.*, 285 B.R. 366, 372-75 (Bankr. N.D. Tex. 2002) (collecting cases and citing James Gadsden, "Recovery of Attorney Fees As an Unsecured Claim," 114 *Banking L.J.* 594, 603 (1997), for its description of a "perceived unfair-

ness" by some courts when disallowing "postpetition attorneys' fees to unsecured creditors"; court also rejected Second Circuit's 1982 *United Merchants* decision for its questionable "logic and importance.").

Other lower courts, however, have noted the unfairness of denying legal fees to such pre-bankruptcy creditors as financial advisers. Indeed, one court stressed why, as a matter of fairness, these claims should be enforced:

There is no provision in the Code for a professional appointed pursuant to Section 327 to seek appointment of another professional to represent its interests at a fee hearing. For attorneys this is not a problem because they are usually well equipped to represent themselves at fee hearings, and they are permitted to seek reimbursement for reasonable fees and expenses incurred in the preparation and defense of their applications *To expect [the financial adviser], a non-attorney professional, to either accept representation from counsel who may suffer a conflict of interest or absorb the cost of representation itself is fundamentally unfair.* This is especially true in light of *the engagement agreement which specifically provided for reimbursement of such fees by [the debtor].* Accordingly, the Court will allow the reimbursement of reasonable fees and expenses incurred by [counsel] in defense of [the adviser's] fee application.

In re Geneva Steel Co., 258 B.R. 799, 803 (Bankr. D.Utah 2001) (Clark, Ch.J.) (emphasis added); *In re EWI, Inc.*, 208 B.R. 885, 895 (Bankr. N.D. Ohio 1999) ("The Court has found that the debtor has a contractual basis to pay [the adviser] for reasonable legal fees"; reasonable fee of counsel in preparing fee application allowed).

The Eleventh Circuit also remanded to the bankruptcy court on appeal "to reconsider [a financial adviser's]

request for reimbursement of attorneys' fees amounting to \$110,351.80 with consideration of the detailed itemization the district court noted in its opinion." *In re Citation Corp.*, 493 F.3d 1313 (11th Cir. 2007). In *Citation*, the financial adviser had sought to be reimbursed for the fees it had paid its counsel. *Id.* at 1316. Because the "bankruptcy court found no itemization for these expenses," it denied the request. *Id.*, n.1. The district court, however, found that the bankruptcy court "must have overlooked [the adviser's] detailed itemization of its attorney's fees ... filed with the court." *Id.* Accordingly, the district court held, and the court of appeals agreed, that "allowance of this amount shall be determined by the Bankruptcy Court" on remand. *Id.*

CONCLUSION

At least two, if not five, Circuits have now put to rest the contractual post-bankruptcy legal fee issue. But there is no uniformity yet, and some lower courts have strongly resisted or ignored appellate guidance from the Supreme Court in *Travelers* and from other courts when they could. Outside the Second, Fourth, Sixth, Ninth and Eleventh Circuits, the contractual legal fee issue is still unresolved. Because bankruptcy litigators thrive on this kind of uncertainty, they will continue to fight over the fee issue until other appellate courts either forge a consensus or until the Supreme Court weighs in to resolve a Circuit split. Despite assertions of unfairness, statutory construction and other technical arguments, *Ogle* and *SNTL* represent the sensible, better-reasoned judicial resolution of the contractual legal fee debate.

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