ALERTS

Appellate Court Reverses Disallowance of Lender's Post-Bankruptcy Legal Fees

December 3, 2018

The Bankruptcy Code ("Code") "does not limit the allowability of unsecured claims for contractual post-[bankruptcy] attorneys' fees," held the U.S. District Court for the District of Delaware on Nov. 26, 2018. *In re Tribune Media Company*, 2018 WL 6167504 (D. Del. Nov. 26, 2018). In a short and sensible opinion, the district court reversed the bankruptcy court's disallowance of an undersecured lender's fees. In its view, the "courts of appeals that have considered this issue … have unanimously … allowed unsecured claims for contractual attorneys' fees that accrued post-filing of the bankruptcy petition." The Third Circuit, it noted, had not ruled on the issue. Nor has there "been a nationwide consensus on the allowability" of these claims. *Id.* at *2.

Relevance

Lower courts have either ignored or misread the Supreme Court's opinion in *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 452-54 (2007) ("[C]laims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed."). *See,* e.g., *Summitbridge Nat'l Investments III LLC v. Faison*, 64 Bankr. Ct. Dec. 247, *3 (E.D.N.C. Nov. 27, 2017) (despite raft of overwhelming appellate authority, a purported "absence of binding [Fourth] Circuit precedent" enabled court to hold that "unsecured creditors are not entitled to post-[bankruptcy] attorneys' fees."). As the court in *Summitbridge* mistakenly reasoned, "a secured creditor [is not permitted] to advance an unsecured claim for post-petition attorneys' fees on the premise that these fees are somehow independent of its secured claim, and thereby avoid the

application of [Code] § 506(b)." *Id.* In its view, the Code allows "only oversecured creditors to add post-petition attorneys' fees." *Id.*[1]

Facts

The lender in *Tribune* was undersecured (i.e., its underlying claim exceeded the value of its collateral). It asserted a $30-million claim for its legal fees in a ten-year-old reorganization case. The debtor objected to the claim and the bankruptcy court sustained that objection, relying on decisions like *Summitbridge*. The bankruptcy court reasoned that Code § 506(b) implicitly limits unsecured claims under § 502. Because § 506(b) allows an oversecured lender reasonable attorneys' fees, Congress, in that court's mistaken view, must have meant to disallow an undersecured lender's claims for legal fees.

Appeal to District Court

The district court "merely note[d]" its unwillingness to hold that § 506(b) "expressly" disallowed the claims for legal fees. It agreed "with the position adopted by every court of appeals faced with this question; Section 506(b) does not limit the allowability of unsecured claims for contractual post-petition attorneys' fees under Section 502."

Comments

At least seven Courts of Appeals have taken a sensible approach to allowing an undersecured creditor's claim for legal fees – if the claim is valid under applicable state law, it is allowable. A comprehensive decision of the Second Circuit, holding that a creditor was entitled to its post-bankruptcy legal fees incurred under a pre-bankruptcy indemnity agreement, illuminates the entire issue. *Ogle v. Fid. & Deposit Co. of Md.*, 586 F.3d 143 (2d Cir. 2009). The Second Circuit explained that the Code "interposes no bar … to recovery." *Id.*, at 148 (citing *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 452 (2007)).

Lenders, financial advisors, accountants, indenture trustees and other professionals who bargain for reimbursement of their legal fees should be reassured by *Tribune* and *Ogle*. Lower courts in the Second Circuit and elsewhere had previously disallowed creditors' professional fees, wrongly holding that (a) nothing in the Code authorizes the payment of these fees, and (b) 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."); *In re Crafts Retail Holding Corp.*, 378 B.R. 44, 50 (Bankr. E.D.N.Y. 2007) ("[A]bsent statutory authority, [financial advisor'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 in *Ogle*, however, the courts had been "closely divided on the" issue of post-bankruptcy fees. 586 F.3d at 145. *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."); *In re Sokolik*, 635 F.3d 261, 267 (7th Cir. 2011); *In re Gencarelli*, 501 F.3d 1, 6 (1st Cir. 2011) (disallowing these "claims based on section 506(b) defies common sense."); *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).

The claim for attorneys' fees in *Ogle* arose from a series of pre-bankruptcy agreements between Fidelity and Agway. Fidelity's efforts to enforce its contractual rights against Agway, however, resulted in protracted litigation during which Fidelity incurred costs, including attorneys' fees. 586 F.3d at 145. The Second Circuit asked whether "an unsecured creditor is entitled to recover post-petition attorneys' fees that were authorized by a pre-petition contract but were contingent on post-petition events?" *Id.* The court answered affirmatively because the Code does not bar these claims.

Code § 502(b) Not a Bar to Recovery. The court first rejected the trustee's argument in *Ogle* that Code § 502(b) precluded the legal fees sought by

Fidelity. Quoting the Supreme Court in *Travelers*, 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 146. (*Travelers*, 549 U.S. at 451) (internal quotation marks omitted).

The contingent nature of the creditor's claim in *Ogle* was also unimportant. As the court explained, Code § 101(5)(A) includes "contingent" claims in its definition of "claim." *Id.* Because applicable state contract law gave the creditor 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.* Moreover, nothing in Code § 502(b) precludes an unsecured creditor's recovery of post-petition attorneys' fees merely because the claim was contingent. *Id.*, at 146-147. *Accord, In re SNTL Corp.*, 571 F3d 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)"). According to the Second Circuit, the Supreme Court's *Travelers* opinion required it to "presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed."

Moreover, none of the exceptions to the allowability of a claim listed in § 502(b) applied to the claim in *Ogle*. 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 147 (quoting *Travelers*, 549 U.S. at 452).

The Second Circuit'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 476 (internal quotation marks omitted).

Code § 506(b) Not a Bar To Recovery. The Second Circuit in *Ogle* 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. Accord. In re SNTL Corp.*, 57 F3d 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) (*en banc*) (§ 502(b) "does not … disallow attorneys' fees of creditors … .").

Timbers Not a Bar to Recovery. 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) 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 stressed 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." *Id.*, at 148.

No Unfairness. Finally, the Second Circuit rejected the trustee's policy argument in *Ogle* that allowance of the fees would "unfairly disadvantage other creditors … whose distributions would be reduced." *Id.*, at 149. Sophisticated parties in *Ogle* 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.* (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.").

Consistent Appellate Decisions. Seven Circuits have put to rest the contractual post-bankruptcy legal fee issue. But there is still no uniformity in the lower courts, as *Tribune* shows. Outside the First, Second, Fourth, Sixth, Seventh, Ninth and Eleventh Circuits, the contractual legal fee issue is still open. The Third Circuit should have no hesitation, though, in affirming the district court's *Tribune* decision.

Authored by Michael L. Cook.

If you have any questions concerning this Alert, please contact your attorney at Schulte Roth & Zabel or the author.

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[1] *See* generally M. L. Cook, "Court Wrongly Disallows Lender's Post-Bankruptcy Legal Fee," *Law 360*, Dec. 8, 2017, available here.

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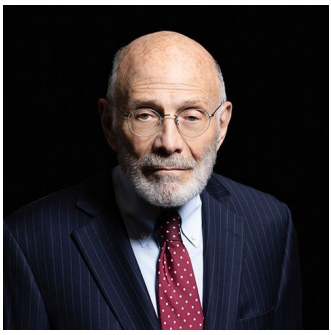

Michael Cook

Of Counsel

New York

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