

Unsecured Creditors May Claim Post-Petition Attorneys' Fees

In a decision that will be of great interest to the creditor community, the US Court of Appeals for the Second Circuit held, on November 5, 2009, that the Bankruptcy Code does not bar an unsecured claim for post-petition attorneys' fees that was authorized under a valid prepetition contract. The case, *Ogle v. Fidelity & Deposit Company of Maryland*,¹ extends and clarifies the US Supreme Court's March 2007 decision in the *Travelers* case,² which opened the door for such a ruling.

In *Travelers*, the Supreme Court swept away the "Fobian rule," so named for a 1991 Ninth Circuit decision which held that in litigation involving issues of bankruptcy law, attorneys' fees will not generally be awarded. The Supreme Court found no statutory basis for the Fobian rule in the Bankruptcy Code and did away with it, summarily, holding that the Bankruptcy Code does not disallow contract-based claims for attorneys' fees based solely on the fact that the fees were incurred litigating bankruptcy law issues. In the words of the opinion: "[a] contract allocating attorneys' fees that is enforceable under [state] law is allowable in bankruptcy except where the Bankruptcy Code provides otherwise."

Ogle takes *Travelers* one important step further, holding that an unsecured creditor is entitled to an allowed claim for post-petition attorneys' fees that were authorized by a prepetition contract, even though the incurrence of such fees was contingent on post-petition events and the amount thereof, necessarily, unliquidated. Of course, as an "allowed" unsecured claim that is deemed to have arisen prepetition, the claim will, as a general matter, ultimately receive the same treatment as all other general unsecured claims in the case.

Here are the central facts in *Ogle*.

Fidelity & Deposit Company of Maryland (Fidelity) issued a number of surety bonds for the benefit of Agway, Inc., to a number of Agway insurers. In connection with the surety bonds, Agway entered into unsecured reimbursement agreements with Fidelity pursuant to which Agway agreed, among other things, to indemnify Fidelity for attorneys' fees that Fidelity might incur to enforce the reimbursement agreements against Agway.

Agway subsequently commenced a chapter 11 bankruptcy proceeding. Up until then, Agway had not defaulted on any payments to its insurers, so Fidelity's proof of claim could only assert a contingent and unliquidated right to payment arising out of any post-petition drawings under its surety bonds. Eventually, Agway did default on its payment obligations to the insurers and the surety bonds were drawn upon. Fidelity, which honored its obligations as issuer of the surety bonds, was unsuccessful in recovering reimbursement from Agway and ultimately incurred \$885,506.28 in attorneys' fees litigating against Agway, post-petition, to recover amounts due to it. *Ogle*, the trustee of the Agway liquidating trust, refused to pay the attorneys' fees. He conceded that, as a matter of applicable state (contract) law, Fidelity had a right to the fees, but asserted that the Bankruptcy Code barred Fidelity's recovery as the fees were incurred post-petition.

After losing his argument, at both the bankruptcy court and the district court, *Ogle* appealed to the Second Circuit Court of Appeals. His view that the Bankruptcy Code precluded a claim for post-petition attorneys' fees was based on two technical statutory arguments.

First, Ogle argued, section 502(b) of the Bankruptcy Code requires the bankruptcy court to determine the *amount* of a claim *as of the petition date*. Only this *amount* can become an allowed claim in a bankruptcy case, according to Ogle. Since *no* amount of attorneys' fees had been incurred as of the petition date, it follows that a claim for post-petition attorneys' fees cannot be allowed. Ogle's second argument was based on section 506(b) of the Bankruptcy Code. Section 506 generally deals with matters relating to *secured* claims. Ogle focused on the language of section 506(b) that states, in relevant part, that:

[T]o 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.

By implication, he argued, if you have an unsecured claim (such as Fidelity's), you are not entitled to an allowed claim for attorneys' fees. He also correctly argued that no other section of the Bankruptcy Code expressly addresses a claimant's right to recover its attorneys' fees and that in the one section that does, the creditor has to be *secured*.

Relying on *Travelers*, the Second Circuit (Chief Judge Jacobs, together with Judges Feinberg and Katzman) began its analysis by considering the breadth of Bankruptcy Code section 101's definition of the term "claim," observing that it includes, among other things, "unliquidated" and "contingent" rights to payment.

Citing an earlier Second Circuit case,³ the court defined a "contingent" claim as one that will become due upon the happening of a future event that was within the parties' contemplation at the time of the contract. Such a claim, ruled the court, is *deemed* to have arisen prepetition. And with regard to a written indemnification contract, in particular, the right to payment arises at the time the indemnification is executed.⁴ Continuing its reliance on *Travelers*, the *Ogle* court holds that a claim for post-petition attorneys' fees *must* be allowed under section 502(b) unless it falls within one of the nine specific exception categories set forth in subsections 502(b)(1)-(9).⁵ Since it does not, it must be deemed to have arisen prepetition and *allowed*.

The Second Circuit also made quick work of Ogle's argument that section 506(b), which allows attorneys' fees in connection with *secured* claims, must disallow claims, by negative inference, where they are *unsecured*. Relying, again, on *Travelers*, the question is not one to be decided on the basis of inference contained in a statute: rather, the question is whether the Bankruptcy Code *disallows* post-petition attorneys' fees, and does so *expressly*. It is decisive, therefore, that the Bankruptcy Code says nothing about unsecured claims for contractual attorneys' fees and, applying the Supreme Court's holding in *Travelers*, the claim must be allowed unless it is expressly unallowable under the Bankruptcy Code—particularly as enumerated in subsections 502(b)(1)-(9).

Conclusion

As a result of *Ogle*, it is now well settled, at least in the Second Circuit, which includes New York, that an unsecured claim may be made for attorneys' fees accruing post-petition if the debtor had agreed prepetition, in an enforceable contract, to indemnify the claimant for such fees.

Action Items

Contracts calling for the defaulting party to pay the non-defaulting party's attorneys' fees in connection with the contract should be drafted in the form of indemnities, as opposed to mere covenants.

When filing a proof of claim against a debtor that has indemnified you for attorney's fees incurred in connection with your contract with the debtor, be certain to include, in addition to all *liquidated* amounts due as of the petition date, an *unliquidated, contingent* claim for attorneys' fees accruing post-petition.

Endnotes

- ¹ No. 09-0691-bk, 2009 WL 3645651, (2nd Cir. Nov. 5, 2009).
- ² *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007).
- ³ *In re Manville Forest Prods. Corp.*, 209 F.3d 125 (2d Cir. 2000).
- ⁴ Given the precise language used by the Second Circuit in *Ogle*, it may be desirable to draft clauses calling for defaulting counterparties to pay non-defaulting parties' attorneys' fees as "indemnifications," as opposed, simply, to a covenant.

⁵ The exceptions are for claims that: are unenforceable against the debtor (§502(b)(1)); are for unmatured interest (§502(b)(2)); are for property taxes that exceed the value of the estate's interest in the property (§502(b)(3)); are for services of an insider or attorney of the debtor and exceed the reasonable value of such services (§502(b)(4)); are for unmatured debt on certain alimony and child support obligations (§502(b)(5)); are for damages resulting from the termination of a lease or an employment contract (§502(b)(6) and (7)); results from a reduction, due to late payment, in the amount of credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor (§502(b)(8)); or were brought to the court's attention through an untimely proof of claim (§502(b)(9)).

Should you have any questions about this subject, do not hesitate to call your usual Mayer Brown contact, or one of the lawyers listed below.

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