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LEGAL EYES

Court of Appeals Rules Unsecured Creditors May Claim Post-Petition Attorneys' Fees

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The United States Court of Appeals for the Second Circuit held on November 2009 that a creditor was entitled to its post-petition legal fees incurred on a prepetition indemnity agreement in the case of *Ogle, Liquidating Trustee of the Agway Liquidating Trust v. Fidelity & Deposit Co. of Maryland*. In affirming the lower courts, the Second Circuit explained that the Bankruptcy Code "interposes no bar to recovery."

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Before Agway filed for Chapter 11, Fidelity & Deposit Co. of Maryland (Fidelity) entered into several agreements (agreements) with the company that required it to indemnify Fidelity for attorneys' fees that it might incur to enforce its agreements with Agway. According to the agreements, Fidelity was to provide surety bonds to Agway's insurers under which it was to be indemnified. Until Agway commenced its Chapter 11 in 2002, it had not defaulted on any payments to its insurers.

As a result, in its proof of claim, Fidelity simply "asserted no more than a contingent right to payment" under the agreements. Agway later defaulted on payments to insurers and Fidelity made payments under the terms of the deals it had signed with Agway. Fidelity then demanded indemnification under the agreements and ultimately incurred $884,506.28 in attorneys' fees in its post-petition action against Agway to recover amounts due to it. The trustee, Ogle, conceded that Fidelity was entitled to the fees under state contract law, but argued that the Code barred Fidelity's recovery.

The issue presented to the Second Circuit was: "[u]nder 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?"

The trustee, Ogle, conceded that Fidelity was entitled to the fees under state contract law, but argued that the Code barred Fidelity's recovery.

The court began its decision by acknowledging that courts are closely divided on this issue. It addressed that one line of cases allows an unsecured claim for post-petition attorneys' fees asserted on the basis of a prepetition contract, while other circuits disallow such a claim. Essentially, the court agreed with the Ninth Circuit's interpretation on the issue whereby the Code does not bar an unsecured claim for post-petition attorneys' fees authorized by a prepetition contract valid under state law.

In his case in point, the trustee admitted that state contract law gave Fidelity a right to its fees, but he refused to pay on the ground that federal bankruptcy laws prohibited the unsecured claims for post-petition attorneys' fees. The trustee argued that the Code requires the court to determine the amount of the claim as of the petition date. Following this reasoning, the trustee contended that only the amount as of the petition date could become an allowed claim and since no amount of attorneys' fees had been incurred as of the petition date, it followed that a claim for post-petition attorneys' fees could not be allowed.

In ruling on this issue, 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." Continuing, the court held that a claim for post-petition attorneys' fees must be allowed under §502(b) of the Code unless it falls within one of the nine specific exception categories set forth in subsections 502(b)(1)-(9) of the Code. Since it did not, the court decided that it must be deemed to have arisen prepetition and allowed.

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Moreover, 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, "courts must 'presume' that the claim 'will be allowed in bankruptcy unless [it is] expressly disallowed.'" The court reasoned that since the contract was valid as a matter of state substantive law and none of exceptions under §502(b) applied, they would allow Fidelity's claim.

Next, the court rejected the trustee's reliance on §506(b), which purportedly only allows interest on a secured creditor's claim. In pertinent part, §506(b) provides that "interest on [a] claim, and any reasonable fees, costs or charges provided for under the agreement of state statute under which such claim arose" can be received if the creditor is oversecured. The trustee sought to argue by implication that an unsecured claim (such as Fidelity's) is not entitled to an allowed claim for attorneys' fees. He also argued that no other section of the Code expressly addresses a claimant's right to recover its attorneys' fees, other than the one section that allows such a claim for a secured creditor.

The court reasoned that sophisticated parties negotiated an agreement with a provision for the recovery of legal fees and, as a result, Fidelity would not be receiving an undeserved bonus at the expense of others.

In addressing this issue, the court rephrased the issue to determine whether the Code disallows post-petition attorneys' fees, and if it does so expressly. Recognizing that "the Code says nothing about unsecured claims for contractual attorneys' fees while litigating issues of bankruptcy law[,]" the court determined that "[§]506(b) does not implicate unsecured claims for post-petition attorneys' fees" and thus "interposes no bar to recovery."

Finally, the court rejected the policy argument that allowance of the fees here would unfairly disadvantage other creditors whose distributions would be reduced. The court reasoned that sophisticated parties negotiated an agreement with a provision for the recovery of legal fees and, as a result, Fidelity would not be receiving an undeserved bonus at the expense of others. Accordingly, allowance of the claim "merely effectuates the bargained-for terms of the loan contract."

As a result of this decision, it is now well settled in the Second Circuit 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. One of the lessons to be learned from this case is that creditors would be well advised to include an unliquidated, contingent claim for attorneys' fees accruing post-petition when filing a proof of claim against a debtor that has indemnified them for attorney's fees incurred in connection with their contract. abfj

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