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Significance Of Ogle V. Fidelity & Deposit Co. Of Md.

by Scott H. Bernstein, Hunton & Williams LLP

Recently, the United States Court of Appeals for the Second Circuit became the second court of appeals to address the question of whether an unsecured creditor is entitled to an allowed claim for attorneys' fees that are incurred post-petition when they are provided for by contract or nonbankruptcy statute.

This question was left unanswered by the United States Supreme Court in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 553 (2007).

In *Travelers*, the Supreme Court expressly overruled *In re Fobian*, 951 F.2d 1149, 1153 (9th Cir. 1991), noting that the only reason given by the lower courts for disallowing attorneys' fees was that the work performed related to issues peculiar to bankruptcy law.

In *Travelers*, the Supreme Court found that there was no basis in the Bankruptcy Code for barring postpetition attorneys' fees on these grounds. However, citing a lack of arguments on the issue before the lower courts or in certiorari petitions, the court declined to rule on whether postpetition attorneys' fees could be included in an unsecured creditor's claim.

Since the *Travelers* decision, courts have been divided on the issue of whether to allow claims for unsecured creditors' postpetition attorneys' fees that are authorized by valid prepetition contracts.

Some, including *SNTL Corp. v. Ctr. Ins. Co. (In re SNTL Corp.)*, 571 F.3d 826, 839-845 (9th Cir. 2009) and *Qmect Inc. v. Burlingame Capital Partners II LP (In re Qmect Inc.)*, 368 B.R. 882, 884 (Bankr. N.D. Cal. 2007), have allowed attorneys' fees.

Others, such as *In re WCS Enters. Inc.*, 381 B.R. 206, 209-10 (Bankr. E.D. Va. 2007) and *In re Elec. Mach. Enters.*, 371 B.R. 549, 552 (Bankr. M.D. Fla. 2007), have not.

This split in authority also existed prior to *Travelers* with the majority of cases holding that unsecured creditors did not have allowed claims for postpetition attorneys' fees.

While these cases diverge in their holdings, they primarily involve arguments citing the fact that section 506(b) of the Bankruptcy Code disallows such claims outright and because they are not fixed "as of the date of the filing of the petition."

The courts are also frequently asked to consider both that the Supreme Court's decision in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs. Ltd.*, 484 U.S. 365 (1988) precludes allowance of such claims, and that prevailing public policy favors disallowing attorneys' fees as well. One recent ruling addressing each of these arguments is the Second Circuit's decision in *Ogle v. Fidelity & Deposit Co. of Md.*, 586 F.3d 143 (2d Cir. 2009).

In *Ogle v. Fidelity*, Fidelity entered into several agreements with Agway Inc., which required Agway to indemnify Fidelity for attorneys' fees that it might incur to enforce the agreements against Agway.

After Agway filed for bankruptcy under Chapter 11, Fidelity made payments to Agway's creditors, unsuccessfully demanded indemnity under the agreements, and incurred attorneys' fees when it sued Agway to collect.

D. Clark Ogle, the liquidating trustee of the Agway Liquidating Trust, conceded that Fidelity had a right to the attorneys' fees under state contract law, but refused to pay on the grounds that the Bankruptcy Code barred such recovery. The bankruptcy court and the lower court held that Fidelity could collect its attorneys' fees from Agway and Ogle subsequently appealed to the Second Circuit.

In its ruling, the Second Circuit held that nothing in the Bankruptcy Code prohibited an unsecured creditor from having an allowed claim for postpetition attorneys' fees pursuant to a prepetition contract that is valid under state law, citing its previous holding in *United Merchants & Manufacturers Inc. v. Equitable Life Assurance Society of the United States*, 674 F.2d 134 (2d Cir. 1982).

In that case, the Second Circuit nullified limitations on the allowance of attorneys' fees incurred in litigation in the bankruptcy court and rejected the argument that it was unfair to give a creditor with a contractual attorneys' fee clause a claim greater in amount than an unsecured creditor without a basis for attorneys' fees. See *id.* at 143-144.

The Bankruptcy Code had been enacted by the time the case came up on appeal and the argument was made that, by enacting section 506(b), Congress had intended to codify a rule applicable under the Bankruptcy Act, prohibiting the award of postpetition fees to unsecured creditors.

The court rejected this theory, concluding that section 506(b) was only intended to address the rights of secured creditors to postpetition fees. See *id.* at 138.

The Second Circuit also considered whether section 502(b) of the Bankruptcy Code disallows postpetition claims for attorneys' fees because they are not fixed "as of the date of the filing of the petition."

Section 502(b) provides (with certain inapplicable exceptions) that a "court, after notice and a hearing, shall determine the amount of [a] claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount." 11 U.S.C. § 502(b). The Second Circuit observed:

"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 postpetition 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.” *Ogle v. Fidelity & Deposit Co. of Md.*, 586 F.3d at 147.

The Second Circuit then found that in the present appeal, as in *Travelers*, none of the section 502(b)(9) exceptions applied, the underlying contract was valid as a matter of state substantive law, and that the Bankruptcy Code is silent as to the question presented in *Travelers* and *Ogle v. Fidelity* of whether the Bankruptcy Code allows unsecured claims for contractual attorneys’ fees incurred while litigating issues of bankruptcy law.

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

Next, the Second Circuit considered whether section 506(b) of the Bankruptcy Code disallows an unsecured creditor’s claim for postpetition attorneys’ fees by negative interference or otherwise.

Section 506(b), entitled “Determination of Secured Status” provides, in relevant part, that “interest on [a] claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose” can be recovered if the creditor is oversecured. 11 U.S.C. § 506(b).

Reaching the same conclusion as in *United Merchants*, the Second Circuit found that section 506(b) and the rest of the Bankruptcy Code is silent about the allowance of an unsecured creditor’s contractual claims for attorneys’ fees.

Accordingly, the Second Circuit held that section 506(b) does not implicate unsecured claims for postpetition attorneys’ fees, and therefore imposes no bar on recovery. See *Ogle v. Fidelity & Deposit Co. of Md.*, 586 F.3d at 147-48.

The Second Circuit also considered whether the Supreme Court’s decision in *United Savings Ass’n of Texas v. Timbers of Inwood Forest Assocs. Ltd.*, 484 U.S. 365 (1988), precludes allowance of such claims.

In *Timbers*, 484 U.S. at 372-73, the Supreme Court held that section 506(b) allows an oversecured creditor to receive postpetition interest only out of the “security cushion,” but that an undersecured creditor, lacking any such cushion, “falls within the general rule disallowing postpetition interest.”

From this holding, the appellant liquidating trustee argued that the Second Circuit should adopt a general rule disallowing postpetition attorneys’ fees.

In response, the Second Circuit held that *Timbers* is not applicable because the general rule disallowing postpetition interest on unsecured debt is set forth in section 502(b), which does not bar (or even reference) claims for postpetition attorneys’ fees. See *Ogle v. Fidelity & Deposit Co. of Md.*, 586 F.3d at 148-49.

Finally, the Second Circuit rejected the argument that allowing unsecured claims for contractual postpetition attorneys’ fees would create a policy that would unfairly disadvantage other

creditors, such as tort claimants and trade creditors, whose distributions would be correspondingly reduced. See *Ogle v. Fidelity & Deposit Co. of Md.*, 586 F.3d at 149.

The court “rejected the idea ‘that the policy of equitable distribution’” in bankruptcy defeats “an unsecured creditor’s otherwise valid contractual claim” for attorneys’ fees. *Id.* (quoting *United Merchants*, 674 F.2d at 137).

In reaching its decision, the Second Circuit became the second court of appeals after *Travelers* to hold that postpetition attorneys’ fees incurred pursuant to a prepetition contract are allowable as part of an unsecured claim.

However, an argument can be made that *Ogle v. Fidelity*, as well as *SNTL Corp. v. Ctr. Ins. Co. (In re SNTL Corp.)*, only provide a definitive statement as to an unsecured creditors’ rights to recover attorneys’ fees that accrue postpetition under a prepetition contractual indemnity.

An expansive reading of this decision may have a negative impact on debtors’ reorganization prospects as individual unsecured creditors may become more litigious in cases where a significant distribution to unsecured creditors is expected.

Debtors will also have to bear the costs and expenses of reviewing unsecured claims that are amended during the course of the cases that add claimants’ attorneys’ fees that have been incurred after the petition date. Debtors, in some cases, may also have to litigate the reasonableness of creditors’ attorneys’ fees.

From the perspective of a vendor supplying goods or services to a financially unstable customer, it now makes more sense to insist on including a contractual right to attorneys’ fees and costs. Distressed investment funds may also pay a premium on claims that are based on contracts providing for the payment of attorneys’ fees.

It will be interesting to see how courts and parties grapple with these implications and others that will spring from the Second Circuit’s decision.

Scott Bernstein is an associate with the bankruptcy practice of Hunton & Williams in the firm’s New York office.