

RUBIN LLC

February 2019

The Unsecured Creditor's Claim for Post-Petition Attorney's Fees Based on a Pre-Petition Contract

Are claims for attorney's fees incurred post-petition by an unsecured creditor having a pre-petition contract that provides for the payment of attorney's fees enforceable against a debtor in bankruptcy? While courts are divided on the issue,[\[1\]](#) a federal district judge in Delaware recently held that the answer is yes, concluding that there is a growing consensus among the circuit courts of appeal that have addressed this question.[\[2\]](#) But a careful reading of the decisions cited by the Delaware district court shows that there are nuances regarding claims for unsecured post-petition attorney's fees that should not be overlooked, and the consensus among circuit courts of appeal may not be as broad as that court suggests.

The Ruling of the District Court in *Tribune*

In its November 2018 decision in an appeal in the Tribune Media Company chapter 11 case, the Delaware district court stated that, while there is no consensus among bankruptcy and district courts on this issue, the circuit courts that have considered this issue following the United States Supreme Court's 2007 decision in the *Travelers* case,[\[3\]](#) have all held that post-petition attorney's fees may be allowed as general unsecured claims where a valid pre-petition contract provides for such fees.

In *Travelers*, the Supreme Court abrogated the so-called "*Fobian* rule"[\[4\]](#) of the Ninth Circuit Court of Appeals, which held that an unsecured creditor's claims for attorney's fees authorized by a pre-petition contract and incurred post-petition are categorically precluded where the creditor incurred the fees litigating issues of federal bankruptcy law. In *Travelers*, the Supreme Court looked to section 502(b) of the Bankruptcy Code to

determine whether an unsecured claim for post-petition contractual attorney's fees should be allowed, and held that "we generally presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed."^[5] But the Supreme Court left the door open to future challenges to attorney's fee claims, stating that "we express no opinion with regard to whether, following the demise of the *Fobian* rule, other principles of bankruptcy law might provide an independent basis for disallowing Traveler's claim for attorney's fees. We conclude only that the Court of Appeals erred in disallowing that claim based on the fact that the fees at issue were incurred litigating issues of bankruptcy law."^[6]

In the *Tribune Media Company* case, the Delaware bankruptcy court disallowed the claim of an indenture trustee, Wilmington Trust Company ("WTC"), for post-petition attorney's fees incurred during the chapter 11 case.^[7] One factor that may have affected the bankruptcy court's decision was the sheer size of WTC's claim for attorney's fees and costs, which exceeded \$30 million. After the debtors objected to the claim, the bankruptcy court appointed a mediator (a retired Delaware district court judge). Ultimately, Judge Carey accepted the mediator's report, which recommended that the claim be disallowed. He accepted the mediator's finding that "it is a reasonable conclusion that Congress would not have to expressly provide for the recovery of post-petition fees by oversecured creditors [in section 506(b) of the Bankruptcy Code] if such fees were generally recoverable by all creditors."^[8] Judge Carey further noted that "the plain language of § 502(b) and § 506(b), when read together, indicated that postpetition interest, attorney's fees and costs are recoverable only by oversecured creditors."^[9]

Reversing the bankruptcy court, the Delaware district court, citing *Travelers*, concluded that Bankruptcy Code section 506(b) did not expressly disallow WTC's claim for post-petition contractual attorney's fees. The district court noted that there was a split in authority in the bankruptcy and district courts, but that there was consensus among the circuit courts following *Travelers* to allow unsecured claims for contractual attorney's fees accruing post-petition. In support of this proposition, the district court cited to decisions by the First, Second, Seventh, and Ninth Circuits, and a pre-*Travelers* decision in the Eleventh Circuit.^[10] Close scrutiny of those circuit court decisions reveals, however, a less robust circuit court consensus on this issue. Indeed, only the Second and Ninth Circuits have addressed the precise issue post-*Travelers*. Moreover, it appears that there are certain factors that inform whether a claim for post-petition attorney's fees should be allowed and may therefore deserve consideration.

The Ninth and Second Circuit Court's Decisions Cited by the District Court in Tribune

In the *SNTL* case,^[11] the Ninth Circuit allowed an unsecured creditor's claims for post-petition contractual attorney's fees. The *SNTL* court affirmed the Ninth Circuit Bankruptcy Appellate Panel's allowance of post-petition attorneys' fee claims and adopted the BAP's

decision in full. The *SNTL* court rejected the four primary arguments for disallowance of these claims. First, the court held that the plain language of section 506(b) of the Bankruptcy Code, read together with section 502(b), does not preclude these claims. The court reasoned that section 506 only governs the classification of allowed claims as secured or unsecured, whereas section 502 determines the allowability of a claim that is not subject to certain enumerated exceptions. It reasoned that because section 502(b) does not contain any express disallowance of post-petition contractual attorney's fees, such fees would be allowed if otherwise permissible under state law. Second, the court held that section 502(b), which provides that the amount of an allowed claim is determined as of the petition date, does not preclude attorney's fee claims simply because they are incurred post-petition, because the attorney's fees are contingent pre-petition claims as of the petition date. Third, the Ninth Circuit rejected reliance on *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*^[12] as a basis for disallowance. *Timbers* stands for the proposition that an undersecured creditor may not receive post-petition interest on the unsecured portion of its debt. This is consistent with section 502(b)'s express disallowance of unmatured interest. But section 502(b) does not contain a similar exception for attorney's fees. Accordingly, the *SNTL* court found *Timbers* inapposite to the issue of whether contractual attorney's fees incurred post-petition could be allowed as an unsecured claim. Fourth and finally, the court determined there was no need to consider the issue as a public policy question, because the Bankruptcy Code specifically does not disallow claims for post-petition attorney's fees. The Ninth Circuit reasoned that Congress could resolve a public policy questions, if it chose to, by amending the Bankruptcy Code.

The Second Circuit, in *Ogle*,^[13] adopted the reasoning of *SNTL*, and held that "an unsecured claim for post-petition fees, authorized by a valid pre-petition contract, is allowable under section 502(b) and is deemed to have arisen pre-petition."^[14] Addressing an issue that the Supreme Court did not reach in *Travelers*, the Second Circuit held that "section 506(b) does not implicate unsecured claims for post-petition attorney's fees, and therefore interposes no bar to recovery."^[15]

While the *SNTL* and *Ogle* decisions clearly enunciate the Ninth and Second Circuit's jurisprudence on this particular issue, the First, Seventh and Eleventh Circuit court decisions cited by the Delaware district court in *Tribune* provide more qualified support for allowance of unsecured claims for post-petition contractual attorney's fees.

The First, Seventh and Eleventh Circuit's Decisions Cited by the District Court in Tribune

In *Gencarelli*,^[16] a case cited by district court in *Tribune*, the First Circuit held that an *oversecured* creditor is entitled to collect a bargained-for prepayment premium from a *solvent* debtor. Thus, on its face, the decision does not address the claim of an unsecured creditor for post-petition attorneys' fees. The *Gencarelli* court noted, however, that "[t]his

is a solvent debtor case and, as such, the equities strongly favor holding the debtor to his contractual obligations so long as those obligations are legally enforceable under applicable non-bankruptcy law. When the debtor is solvent, the bankruptcy rule is that where there is a *contractual* provision, valid under state law, ... the bankruptcy court will enforce the contractual provision.”[\[17\]](#) The court also specifically distinguished *Travelers*: “[T]his opinion should not be construed as speaking to the different question of whether an unsecured creditor can enforce a contractual right to post-petition fees against the estate of an *insolvent* debtor under section 502.”[\[18\]](#) *Gencarelli* left that question unanswered.

Similarly, the Seventh Circuit’s decision[\[19\]](#) cited by the district court in *Tribune* provides little guidance concerning whether an unsecured creditor’s claim for contractual post-petition attorney’s fees is allowable. There, the Seventh Circuit’s discussion of the right to attorney’s fees was fairly limited. It cited *Travelers* to support its holding that “[t]he fact that the fees were incurred litigating a bankruptcy case does not disallow [the creditor’s] contract based claim for attorney’s fees under *Travelers*. ... Furthermore, [the debtor] has not argued that any portion of the Bankruptcy Code specifically prohibits a court from awarding such fees under a contract theory.”[\[20\]](#) Thus the Seventh Circuit in *Sokolik* did not specifically consider whether sections 502(b) and 506(b) of the Bankruptcy Code contain an express statutory bar to allowance of post-petition attorney’s fees.

In *Tribune*, the Delaware district court also cited to a pre-*Travelers* Eleventh Circuit decision.[\[21\]](#) But that case involved an *oversecured* creditor’s claim for contractual attorney’s fees. The *Welzel* court held that an oversecured creditor’s claim for attorney’s fees was allowable under section 502(b) because no exceptions set forth in the Bankruptcy Code applied to preclude the claim. Those fees, however, would be subject to a determination of reasonableness under section 506(b), and the portion of the fees deemed reasonable would constitute an allowed secured claim, with the remaining portion an unsecured claim. The Eleventh Circuit held that the lower court erred by disallowing the entire portion of the attorney’s fees that was deemed unreasonable. The facts of the *Welzel* decision take it outside the narrow contours of the question of whether an *unsecured* (as opposed to an oversecured) creditor’s claim for post-petition contractual attorney’s fees is allowable. Nevertheless, the *Welzel* court noted that the bifurcation approach for attorney’s fees under section 506(b) made sense, so that unsecured creditors who can assert unsecured claim for contractual attorney’s fees would not be unfairly advantaged.

Conclusion

A review of the circuit decisions cited by the Delaware district court in *Tribune* demonstrates that the apparent consensus among the circuit courts of appeals to allow unsecured claims for post-petition contractual attorney’s fees may not be as widespread as the district court believed. If and when the Third Circuit decides the appeal of the

Delaware district court's *Tribune*, we may get a clearer picture of whether a growing consensus favoring allowance of such claims is indeed forming.

-
- [1] Compare *In re Old Colony, LLC*, 476 B.R. 1 (D. Mass. 2012); *In re Seda France, Inc.*, Case No. 10-12948 CAG, 2011 WL 3022563 (Bankr. W.D. Tex. July 22, 2011); *In re Electric Machinery Enters., Inc.*, 371 B.R. 549 (Bankr. M.D. Fla. 2007) (cases disallowing unsecured claims for post-petition contractual attorney's fees); with *In re Holden*, 491 B.R. 728 (Bankr. E.D.N.C. 2013); *In re Qmect, Inc.*, 368 B.R. 882 (Bankr. N.D. Cal. 2007) (cases allowing unsecured claims for post-petition contractual attorney's fees).
- [2] *Wilmington Trust Co. v. Tribune Media Co. (In re Tribune Media Co., et al.)*, Case No. 15-01116 (RGA), 2018 WL 6167504 (D. Del. Nov. 26, 2018).
- [3] *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007).
- [4] This rule takes its name from the Ninth Circuit Court of Appeals' decision in *In re Fobian*, 951 F.2d 1149 (9th Cir. 1991).
- [5] *Travelers*, 549 U.S. at 452 (citing 11 U.S.C. § 502(b)).
- [6] *Id.* at 456.
- [7] See *In re Tribune Media Co.*, 2015 WL 7307305 (Bankr. D. Del. Nov. 19, 2015), *rev'd*, 2018 WL 6167504 (D. Del. Nov. 26, 2018).
- [8] *In re Tribune Media Co.*, 2015 WL 7307305 at *3.
- [9] *Id.*
- [10] Although the district court in *Tribune* cited *UPS Capital Bus. Credit v. Gencarelli (In re Gencarelli)*, 501 F.3d 1 (1st Cir. 2007), as a First Circuit case pre-dating *Travelers*, that decision was decided after *Travelers* and even cites to it.
- [11] *SNTL Corp. v. Centre Ins. Co. (In re SNTL Corp.)*, 571 F.3d 826 (9th Cir. 2009).
- [12] 484 U.S. 365 (1988).
- [13] *Ogle v. Fidelity & Deposit Co. of Md.*, 586 F.3d 143 (2d Cir. 2009).
- [14] *Id.* at 147.
- [15] *Id.* at 148.
- [16] *UPS Capital Bus. Credit v. Gencarelli (In re Gencarelli)*, 501 F.3d 1 (1st Cir. 2007).
- [17] *Gencarelli*, 501 F.3d at 7 (citation and quotation omitted, emphasis and second alteration in original).
- [18] *Id.* at 7 n.3 (citing *Travelers*).
- [19] *Busson-Sokolik v. Milwaukee Sch. of Eng'g (In re Sokolik)*, 635 F.3d 261 (7th Cir. 2011).
- [20] See *id.* at 267.
- [21] *Welzel v Advocate Realty Invs., LLC (In re Welzel)*, 275 F.3d 1308 (11th Cir. 2001).

If you have questions concerning the content of this Alert or would like more information about Rubin LLC, please contact:

Paul A. Rubin

Rubin LLC

345 Seventh Avenue, 21st Floor

New York, NY 10001

Tel: 212.390.8054

E-Mail: prubin@rubinlawllc.com

Web: www.rubinlawllc.com

This communication has been prepared for informational purposes only and is not intended and should not be considered legal advice. Viewers should not act upon this information without seeking professional counsel based on their specific situations.

If you would like to add a colleague or need to change your contact information, please send an email to asst@rubinlawllc.com.