

TIP OF THE MONTH

DEVELOPING CASE LAW ON UNSECURED POST-PETITION ATTORNEYS'S FEES

The Ninth Circuit Bankruptcy Appellate Panel recently rendered an opinion, *In The Matter of SNTL*, Bankruptcy Case Number 08-60001-BAP, Case Number cv-06-1350-MoDK, filed June 23, 2009. In the *SNTL* decision, the Court dealt with several issues, including holding that when an obligee returns a payment on a preference avoidance action, a guarantor on the underlying debt is not discharged of the guarantor's obligation to pay the debt. That holding is consistent with a number of cases that deal with reinstatement of debt, upon payment of a preference by the obligee.

The larger issue of the *SNTL* case dealt with the allowance, as part of the creditor's unsecured claim, post-petition attorneys' fees. The BAP acknowledged that an appeal is still pending on the claim question before the Ninth Circuit, on remand by the U.S. Supreme Court in the *Travelers*¹ decision. The BAP indicated that they were deciding the issue, rather than delay the BAP appeal. The BAP also indicated that at least two bankruptcy courts have disagreed on the issue of whether an unsecured creditor can recover fees incurred post-petition. The Court identified four primary arguments asserted in favor of, and against the allowance of such claims:

1. Whether Section 506(b) operates to disallow such claims;
2. Whether Section 502(b) disallows such claims, because they were not fixed "as of the date of the filing of the petition;"
3. Whether the Supreme Court's decision in *United Savings Association of Texas vs. Timbers of Inwood Forest Associates, Limited*² precludes allowance of such claims;

¹ *Travelers Casualty & Surety Co. Of America v. Pacific Gas & Electric Co.*, — U.S. —, 127 S. Ct. 1199, 1206 (2007).

² 484 U.S. 365 (1988).

4. Whether public policy favors the disallowance of such claims.

As to the first argument, the Court adopted, with favor, the holding in the case *Qmext, Inc. vs. Burlingame Capital Partners II, LP*,³ and held that 506(b) does not limit allowance of the fees as part of an unsecured claim, but merely defines the portion of the fees which shall be afforded secured status. The Court went on to state that Section 502(b) applies to claims generally, and does disallow unmatured interest, but does not specifically disallow attorneys' fees of creditors. The Court determined that 506(b) is not relevant in determining the allowance of an unsecured claim and that one must look to Section 502 to determine the issue.

The Court then discussed the second argument, under Section 502(b), and held that Section 502(b) does not specifically disallow such fees, citing the *Qmext* decision. The Court agreed with bankruptcy case law that held that so long as the right to collect fees existed pre-petition, the fact that fees were actually incurred during the post-petition period was not relevant to the determination of whether the creditor has an allowable pre-petition claim for fees. The Court indicated that approach was consistent with the Ninth Circuit's "fair contemplation" test. That test being whether the "post-petition fees can be fairly contemplated when the parties have provided for them in their contracts and thus are contingent claims as of the petition date." The fees are pre-petition in nature, constituting a contingent pre-petition obligation that becomes fixed post-petition, when the fees are incurred. The Court determined that such post-petition fees arising out of a pre-petition contract, fall within the bankruptcy code's broad definition of claim and that such fees should not be precluded as part of the claim.

As to the third argument that the *Timbers* case by the Supreme Court precludes allowance of such claims, the Court stated that *Timbers* provided that an undersecured creditor could not

³ *In re Qmext, Inc.*, 368 BR 882 (Bk N.D. Cal. 2007).

receive post-petition interest on the unsecured portion of its debt. The Court indicated that the *Timbers* holding was consistent with Section 502(b)(2), which specifically disallows claims for unmatured interest. The Court, held that neither Section 506(b) nor *Timbers* bars unsecured creditors from asserting a contractual or statutory claim for post-petition attorneys' fees.

The final argument was under public policy concerns. The Court indicated that there were public policy arguments on both sides. The cases that have disallowed the post-petition claim of attorneys fees and costs on an unsecured claim have promoted "equality of distribution" and to prevent individual creditors from using scorched-earth litigation tactics or absorbing an inequitable amount of an estate's assets in post-petition litigation. The Court indicated, in contrast, the Court in *Qmect* identified a different policy reason for allowance of claims; to prevent the unfairness of a debtor recovering such fees while the creditor is prohibited from a similar recovery.

The BAP indicated that the bankruptcy code provided the answer to the issue, by not specifically disallowing post-petition fees, and that the BAP would not attempt to reconcile the different public policy concerns, as that was the province of Congress to correct any statutory disfunctions and to resolve difficult policy questions embedded in the statutes.

As such, the BAP in *SNTL* followed the *Qmect* decision in holding that the creditor in that case was entitled to post-petition attorneys' fees as part of its unsecured claim under Section 502. The BAP remanded the case to the Bankruptcy Court to determine whether the creditor had satisfied the requisites for allowance of that portion of its claim under the relevant contracts and state law.

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