

BANKRUPTCY ALERT

POSTPETITION ATTORNEYS' FEES ALLOWED FOR UNSECURED CREDITORS, PREFERENCE RECOVERY REINSTATES GUARANTY

On June 23, 2009, in *SNTL Corp. v. Centre Ins. Co. (In re SNTL Corp.)*,¹ the United States Court of Appeals for the 9th Circuit ruled that unsecured creditors of a bankruptcy estate may be allowed claims for postpetition attorneys' fees if the claimant is entitled to such fees under the governing contracts or state law, unless other grounds exist for disallowing the claim (apart from the creditor's status as an unsecured creditor). With its opinion, the 9th Circuit became the first circuit court to decide whether to allow claims for postpetition attorneys' fees incurred by an unsecured creditor. In an opinion with far-reaching implications for unsecured creditors, the court also held that, despite the prepetition settlement and release of a guarantor in exchange for a payment from the principal obligor, the guaranty may be reinstated and allowed as a claim against the debtor guarantor in its subsequent bankruptcy case if the prepetition payment is avoided and repaid to the principal obligor as a preference, even though the avoidance and repayment of the preference occurs postpetition.²

SNTL Corp. and its affiliates filed Chapter 11 petitions for bankruptcy relief. Centre Insurance Co. filed a proof of claim for over \$232 million, excluding contingent and unliquidated claims but including attorneys' fees incurred postpetition. The trustee objected to Centre's proof of claim on the basis that Centre had released its claims against the debtor prior to the filing of the bankruptcy and, therefore, could not assert these claims postpetition. The trustee further objected to Centre's claim for postpetition attorneys' fees on the grounds that Centre was an unsecured creditor.

¹ Akin Gump is co-counsel to Centre Insurance Company in *SNTL Corp. v. Centre Ins. Co. (In re SNTL Corp.)*

² *Centre Ins. Co. v. SNTL Corp. (In re SNTL Corp.)*, No. 08-60001, ___ F. 3d ___, 2009 WL 1758759 (9th Cir. June 23, 2009).

Prior to filing for bankruptcy, debtor Superior National Insurance Group (SNIG) guaranteed certain of its affiliates obligations to Centre. Upon default on these obligations, the affiliates paid Centre \$163.4 million in satisfaction of a \$180 million debt in exchange for Centre's release of the principal obligor and of SNIG as guarantor. The affiliates—insurance companies—were placed into a state court-supervised liquidation, and SNIG then filed a Chapter 11 case. The liquidator of the affiliates subsequently filed a state court preference action to recover the payment made by the affiliates to Centre. In settlement of the preference claim, Centre returned \$110 million of the \$163.4 million payment to the liquidator. Centre then filed a claim in SNIG's bankruptcy case to recover the \$110 million from SNIG, as guarantor. The trustee objected, arguing that Centre could not assert the guaranty claim postpetition since it had been released prepetition. Centre also filed a claim for attorneys' fees incurred postpetition, asserting that its prepetition contracts permitted it to recover such costs. The trustee filed a motion for summary adjudication claiming that Centre had released SNIG's liability as guarantor prepetition, and that, as unsecured creditor, Centre could not assert a claim for attorneys' fees incurred postpetition. The bankruptcy court granted the trustee's motion for summary adjudication as to both issues. The Bankruptcy Appellate Panel for the 9th Circuit (BAP) reversed the Bankruptcy Court order.³ The trustee appealed the BAP decision to the 9th Circuit.

The 9th Circuit, per curiam, adopted the opinion of the BAP, reversing the bankruptcy court's decision on both points. In determining that the avoidance and repayment of the \$110 million as a preference reinstated SNIG's liability as guarantor, the court conducted the following analysis. The agreement governing the release of SNIG as guarantor provided that Centre's remedies against SNIG could be revived if a court determined that the settlement payments to Centre were avoidable preference payments. At the time Centre returned \$110 million of the \$163.4 million payment in settlement of the liquidator's state court preference claim, the state court entered an order approving the settlement. The BAP found that this state court order triggered the provision restoring Centre's remedies against SNIG. The BAP also reasoned that, under guaranty law, when a creditor returns a preference payment to its principal obligor, a guarantor's liability is restored. The trustee asserted that, even if the court found that SNIG's liability was reinstated under the release and guaranty law, Section 502(b) of the Bankruptcy Code would preclude Centre from recovering the \$110 million repayment (Section 502(b) requires a court to assess the amount of a prepetition claim "as of the petition date"). The trustee maintained that, as of the petition date, Centre had released its claim against SNIG. The BAP recognized, however, that Section 502(b) does not disallow a claim on the basis that it is contingent. Centre's claim existed as a contingent claim as of the petition date. Because Centre's claim against SNIG was restored by the recovery of the preference payment, the BAP reversed the bankruptcy court's holding regarding guarantor liability.

³ *In re SNTL Corp.*, 380 B.R. 204 (B.A.P. 9th Cir. 2007).

Next, the BAP evaluated Centre's claim as a general unsecured creditor for postpetition attorneys' fees. In *Travelers Casualty & Surety Co. v. Pacific Gas & Electric Co.*, the U.S. Supreme Court had declined to decide whether a bankruptcy court may allow an unsecured creditor's claim for postpetition attorneys' fees and, instead, remanded the issue to the 9th Circuit.⁴ The *Travelers* decision reversed former 9th Circuit case law denying creditors' claims for attorneys' fees for bankruptcy litigation and held that such attorneys' fees may be allowed if provided for in a prepetition contract with the debtor.⁵ Since the Supreme Court issued the decision, courts have been split on whether an unsecured creditor's claim for postpetition attorneys' fees may be allowed.⁶ In analyzing this issue, the BAP noted that courts, both before and after the *Travelers* holding, have focused on four main arguments:

- First, courts have considered whether Section 506(b) of the Bankruptcy Code disallows an unsecured creditor's claim for postpetition attorneys' fees. The BAP rejected the contention that Section 506(b), which circumscribes only secured claims, restricts unsecured claims.
- Second, courts have looked to Section 502(b)'s requirement that a claim be measured as of the petition date. Although the amount of postpetition attorneys' fees is not certain as of the petition date, the BAP found that, because the right to payment existed as of the petition date, Section 502(b) did not preclude an unsecured creditor's claim to postpetition attorneys' fees.
- Third, courts have considered whether the Supreme Court's decision in *Timbers* prevents an unsecured creditor from recovering postpetition attorneys' fees.⁷ *Timbers* held that an undersecured creditor was not entitled to interest on its unsecured debt.⁸ The BAP held that *Timbers* was not applicable because Section 502(b) disallows interest on unsecured debt but does not prevent a claim for attorneys' fees.
- Fourth, courts have evaluated public policy. The BAP, however, deemed a public policy analysis unnecessary because the Bankruptcy Code controls the issue. Ultimately, the BAP concluded that postpetition attorneys' fees should not be disallowed solely because the claimant is a general unsecured creditor.

CONCLUSION

In issuing its opinion, the 9th Circuit became the first circuit court to decide whether to award postpetition attorneys' fees to an unsecured creditor since the Supreme Court's ruling in *Travelers*.⁹

⁴ 127 S. Ct. 1199 (2007).

⁵ See *In re SNTL Corp.*, 380 B.R. at 217; Collier on Bankruptcy § 502.03[2][b][iv] (citing *Fobian v. W. Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991)).

⁶ *In re SNTL Corp.*, 380 B.R. 218 (citing *Qmect, Inc. v. Burlingame Capital Partners II, LP (In re Qmect, Inc.)*, 368 B.R. 882 (Bankr. N.D. Cal. 2007); *In re Elec. Mach. Enters., Inc.*, 371 B.R. 549 (Bankr. M.D. Fla. 2007)).

⁷ *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988).

⁸ *In re SNTL Corp.*, 380 B.R. 222 (citing *Timbers*, 484 U.S. at 380).

⁹ 127 S. Ct. 1199.

Since the Supreme Court issued the Travelers decision, courts have struggled with whether to allow unsecured creditors postpetition attorneys' fees and have come down on both sides of the issue.¹⁰ The SNTL Corp. opinion demonstrates that, at least in some instances, a claim for postpetition attorneys' fees is available to unsecured creditors. In addition, the SNTL Corp. case demonstrates that, notwithstanding a prepetition settlement and release of a guarantor, a guaranty may be revived if the prepetition settlement payment is returned to the principal obligor as a preference, whether the repayment occurs after avoidance by court order or in a court-approved settlement of the preference claim.

¹⁰ Compare *In re SNTL Corp.*, 380 B.R. 204 with *In re WCS Enters., Inc.*, 381 B.R. 206 (Bankr. E.D. Va. 2007).

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