

DEC 19 2007

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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

In re:	)	BAP No.	CC-06-1350-MoDK
	)		
SNTL CORP.; SN INSURANCE	)	Bk. Nos.	SV 00-14099-GM
SERVICES, INC.; SNTL HOLDINGS	)		SV 00-14100-GM
CORP.; SN INSURANCE	)		SV 00-14101-GM
ADMINISTRATORS, INC.; INFONET	)		SV 00-14102-GM
MANAGEMENT SYSTEMS, INC.;	)		SV 02-14236-GM
PACIFIC INSURANCE BROKERAGE,	)		SV 02-14239-GM
INC.,	)		(Jointly Administered)
	)		
Debtors.	)		

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CENTRE INSURANCE COMPANY,  
Appellant,

v.

O P I N I O N

SNTL CORP.; SN INSURANCE  
SERVICES, INC.; SNTL HOLDINGS  
CORP.; SN INSURANCE  
ADMINISTRATORS, INC.; INFONET  
MANAGEMENT SYSTEMS, INC.;

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PACIFIC INSURANCE BROKERAGE,  
INC.,  
Appellees.

Argued and Submitted on September 21, 2007  
at Pasadena, California

Filed - December 19, 2007

Appeal from the United States Bankruptcy Court  
for the Central District of California

Honorable Geraldine Mund, Bankruptcy Judge, Presiding

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Before: MONTALI, DUNN and KLEIN, Bankruptcy Judges.

1 MONTALI, Bankruptcy Judge:

2  
3 In this complicated and high-stakes case, we apply a  
4 somewhat obscure doctrine that involves the intersection of  
5 insolvency law principles and guaranty law, illustrating the  
6 temporal nature of a release of a guarantor when a voidable  
7 preference is recovered from the obligee. We also will be one of  
8 the first courts to address a question left unanswered by the  
9 Supreme Court earlier this year: May an unsecured creditor  
10 include attorneys' fees incurred postpetition but arising from a  
11 prepetition contract as part of its unsecured claim?

12 Here a creditor contended that the debtor's previously  
13 released liability as a guarantor of an affiliate's obligation  
14 was revived when the creditor compromised a preference action  
15 against it. The bankruptcy court disagreed and entered summary  
16 judgment disallowing the creditor's multimillion dollar claim and  
17 denying the creditor's request for postpetition attorneys' fees  
18 and costs. The creditor appeals, and we REVERSE and REMAND.

19 **I. FACTS**

20 A. The Parties

21 On April 26, 2000 (the "petition date"), SNTL Corporation  
22 (formerly known as Superior National Insurance Group)<sup>1</sup> and its  
23 non-insurer affiliates SN Insurance Services, Inc., SNTL Holdings  
24 Corporation (formerly known as Business Insurance Group, Inc.),  
25 and SN Insurance Administrators, Inc. (collectively, "Debtors")

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<sup>1</sup> SNTL Corporation is the post-confirmation successor to Superior National Insurance Group and will be referred to as "SNIG" in this opinion.

1 each filed chapter 11 petitions<sup>2</sup> for relief.

2 Pursuant to a confirmed joint plan of reorganization  
3 ("Plan"), an SNTL Litigation Trust ("Trust") was formed and an  
4 SNTL Litigation Trustee ("Trustee") was appointed. The Trustee  
5 was authorized to prosecute certain claims, rights and causes of  
6 actions and to oversee and initiate actions pertaining to the  
7 allowance and payment of claims, including objections to proofs  
8 of claims.

9 Appellant Centre Insurance Company ("Centre") filed a proof  
10 of claim in November 2000 asserting a claim in excess of  
11 \$294,488,911 (including approximately \$3 million in attorneys'  
12 fees but not including contingent and unliquidated amounts) and  
13 an amended proof of claim in March 2005 in the amount of  
14 \$232,748,280.40. The Trustee filed an objection to Centre's  
15 claim arguing, inter alia, that Centre had released claims  
16 against SNIG prepetition, that the released claims could not be  
17 revived by postpetition events and that Centre, as an unsecured  
18 creditor, could not include in its claim attorneys' fees incurred  
19 postpetition.

20 B. Pertinent Transactions and Events

21 The relationship of the parties, and the nature of the  
22 transactions summarized below, are complex and perhaps unique to  
23 the insurance and reinsurance industry. Reduced to their central  
24 elements, however, they can be summarized as follows: Debtor

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26 <sup>2</sup> Unless otherwise indicated, all chapter, section and rule  
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and  
28 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as  
enacted and promulgated prior to the effective date of The  
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,  
Pub. L. 109-8, 119 Stat. 23 (Apr. 20, 2005).

1 SNIG guaranteed the performance of its affiliates' obligations to  
2 Centre. Following default on these obligations, the parties  
3 reached an agreement whereby the affiliates paid Centre \$163.4  
4 million to satisfy an obligation of \$180 million and Centre  
5 simultaneously released the guarantor (SNIG). Thereafter, in  
6 settlement of a preference action brought by the liquidator of  
7 the affiliate insurance companies, Centre returned a portion of  
8 the \$163.4 million payment. Centre now seeks to recover the  
9 returned amount (\$110 million) from the guarantor SNIG; Trustee  
10 asserts that SNIG's released liability cannot be revived.

11 More specifically, on December 18, 1998, SNIG sold its  
12 affiliate Business Insurance Company ("BICO") to Centre Solutions  
13 Holdings (Delaware Limited) ("Centre Solutions"); BICO became  
14 known as Centre. On the same day, Centre entered into certain  
15 reinsurance agreements (the "LPT and Quota Share Agreements")  
16 with insurance companies affiliated with SNIG: California  
17 Compensation Insurance Company ("CalComp") and Superior National  
18 Insurance Company ("SNIC"). SNIG guaranteed performance of one  
19 of these reinsurance agreements known as the "QSR Contract."

20 In addition, the parties also entered into fronting  
21 (service) agreements known as the Underwriting Management  
22 Agreement ("UMA") and the Claims Administration Services  
23 Agreement ("CSA"). SNIG also guaranteed performance of these  
24 agreements. The UMA, CSA, LPT and Quota Share Agreements are  
25 collectively referred to as the "Fronting Agreements."<sup>3</sup> The

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26  
27 <sup>3</sup> The Fronting Agreements provide for the recovery of all  
28 reasonable expenses, including attorneys' fees, incurred in the  
enforcement of SNIG's guaranty. Under the Fronting Agreements,  
SNIG sold insurance policies using Centre's name and "A"

(continued...)

1 Fronting Agreements provide for the recovery of all reasonable  
2 expenses, including attorney's fees, incurred in the enforcement  
3 of SNIG's guaranty.

4 The Fronting Agreements were breached in late 1999. On  
5 December 31, 1999, Centre entered into a Partial Commutation and  
6 Settlement Agreement ("PCSA") with CalComp, SNIC and SNIG. The  
7 PCSA modified the Fronting Agreements and provided for a partial  
8 release of the reinsurance obligations of SNIG, CalComp, SNIC and  
9 all of their parents and affiliates (among others) up to \$180  
10 million (the "Release").<sup>4</sup>

11 In exchange for the Release, SNIG, CalComp and SNIC agreed

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12  
13 <sup>3</sup>(...continued)  
14 financial rating. SNIG marketed, underwrote and administered the  
15 policies, and received the premiums and paid the claims arising  
under them. Centre received a fee for the use of its name and  
financial rating.

16 <sup>4</sup> The Release provided in pertinent part:

17 Subject to receipt of the Commutation Payment, [Centre]  
18 does hereby release and forever discharge the  
19 Reinsurers, their predecessors, successors, parents,  
20 affiliates, agents, officers, directors and  
21 shareholders and assigns from any and all past, present  
22 and future payment obligations, adjustments,  
23 executions, offsets, actions, causes of action, suits,  
24 debts, sums of money, accounts, reckonings, bonds,  
25 bills, covenants, contracts, controversies, agreements,  
26 promises, damages, judgments, claims, demands,  
liabilities and/or losses whatsoever, all whether known  
or unknown, which [Centre] and their successors and  
assigns ever had, now have, or hereinafter may have,  
whether grounded in law or equity relating, directly or  
indirectly, to the terms and conditions of the LPT and  
Quota Share Agreements. . . .

27 PCSA at 3. In addition, Article III of the PCSA excepted from  
28 the Release claims exceeding \$180 million, stating that the LPT  
and Quota Share Agreements remained in full force and effect  
"with respect to the cession of Losses, Loss Adjustment Expenses  
and unearned premium reserves, in excess of \$180,000,000." Id.

1 to meet six conditions, including payment of a \$163.4 million  
2 Partial Commutation Payment ("Payment") by CalComp and SNIC.  
3 Centre received the Payment; no evidence was introduced that any  
4 of the six conditions for the Release were unsatisfied. In its  
5 opening brief, Centre acknowledges that "the primary obligors and  
6 SN Holdings [SNIG] (the guarantor) were released from liability  
7 for up to \$180 million" in exchange for the Payment. Appellant's  
8 Opening Brief at 13. Consequently, the Release in the PCSA  
9 became effective prepetition.

10 Article X of the PCSA provided that the Release could be  
11 revoked by Centre if the PCA or other payments made pursuant to  
12 the PCSA were found to be voidable or preferential transfers,  
13 stating in pertinent part:

14 In the event that any court of competent jurisdiction  
15 or governmental or regulatory authority asserting  
16 jurisdiction over the subject matter hereof or the  
17 parties hereto enters a final order, judgment, or other  
18 finding that: (i) the payment of all or any part of the  
19 \$22,300,000, described above, or (ii) the payment by  
20 Reinsurers of all or any part of the [Payment] of  
21 \$163,400,000, or (iii) any of the consideration  
22 described in the Recitals to this Agreement . . .  
23 constitutes a voidable or preferential transfer, such  
24 payment constitutes an improper or disproportionate  
25 payment, or the payment is otherwise in violation of  
26 law or subject to a claim or [sic] preference, then  
27 [Centre] may in its sole discretion, in addition to any  
28 other remedy provided by law, equity, statute, or  
contract: (a) enforce this Agreement according to its  
express terms and conditions; or (b) declare this  
Agreement to be null and void in its entirety, and  
thereupon enforce the terms and conditions of the LPT  
and Quota Share Agreements as though this Agreement  
(including without limitation the releases and  
discharges set forth in Articles III and IV) had not  
been executed. . . .

26 PCSA at 8-9.

27 In March 2000, the Insurance Commissioner for the State of  
28 California (the "Commissioner") placed certain insurance

1 companies affiliated with Debtors into conservation, followed by  
2 liquidation. In January 2002 (approximately fourteen months  
3 after the petition date), the Commissioner filed a complaint in  
4 state court against Centre and others, seeking in part the return  
5 of the Payment from Centre as an avoidable preference under state  
6 law preference provisions.

7 Centre subsequently agreed to settle that state court  
8 litigation, and on February 17, 2005, the state court entered an  
9 order approving a settlement agreement between the Commissioner  
10 and Centre (among others) providing that the Commissioner's  
11 avoidance action would be dismissed in exchange for Centre's  
12 partial return (in the amount of \$110 million) of the Payment.  
13 Paragraph F of the state court order indicated that the  
14 Commissioner sought to recover property transferred by the  
15 insurance companies to Centre and that the Commissioner had  
16 sought avoidance of such transfers.<sup>5</sup>

17 The order also provided that the settlement agreement  
18 between the Commissioner and Centre was "fully and finally  
19 approved." In turn, the settlement agreement itself provided  
20 that "[t]he payments to the Liquidator under section III.C.1 of  
21 this Settlement Agreement are payments on account of the claims

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22  
23 <sup>5</sup> Paragraph F provided: "The property that the Liquidator  
24 [Commissioner] seeks to recover in the Action (including, without  
25 limitation, the property which is the subject of each claim in  
26 the Action seeking the avoidance of a transfer of property) is  
27 property of one or more of the SNICIL [Superior National  
28 Insurance Company, Superior Pacific Casualty Company, California  
Compensation Insurance Company, Commercial Compensation Casualty  
Company, and Combined Benefits Insurance Company], which property  
was transferred to CIC [Centre] (or, in certain instances,  
certain other defendants) from one or more of the SNICIL."

1 of the Liquidator arising from payments asserted to be  
2 preferential transfers . . . and not payments on account of any  
3 tort claims." Settlement Agreement and Mutual Release at 15.

4 In its initial proof of claim filed in November 2000, Centre  
5 stated that SNIG's liability as guarantor was for amounts "in  
6 excess of \$180,000,000" and reserved the right to seek additional  
7 amounts if any portion of the Payment was "deemed void or  
8 avoidable," specifically mentioning the then-pending avoidance  
9 action by the Commissioner. The amended proof of claim does not  
10 specifically mention the avoidance action or its effect on the  
11 Release, but as will be shown, the battle is all about Centre's  
12 contention that the amended claim can include the amount paid to  
13 the Commissioner as well as postpetition attorneys' fees.

14 Trustee objected to Centre's claim and amended claim on many  
15 grounds, although only four are relevant to this appeal: (1)  
16 Centre's claim arising from SNIG's guaranty obligations had been  
17 released and could not be revived as Centre had not obtained a  
18 judicial finding or judgment that the Payment (or other payment  
19 made under the PCSA) constituted a preferential transfer as  
20 required by Article X of the PCSA, (2) even if Centre had  
21 obtained such a judicial finding or judgment, it has not  
22 exercised its right of revocation and no other remedy is  
23 available, (3) Centre's claim arising from SNIG's guaranty  
24 obligations was not contingent but was instead extinguished  
25 prepetition under the Release and, under section 502(b), could  
26 not be revived by any postpetition determination that the Payment  
27 was a preference, and (4) Centre was an unsecured creditor and  
28 thus could not assert a claim for attorneys' fees incurred



1 postpetition.

2 In April 2006, Trustee filed a motion for partial summary  
3 judgment that the Release extinguished SNIG's liability as  
4 guarantor, at least up to \$180 million, and that Centre could not  
5 recover attorneys' fees incurred postpetition. After conducting  
6 a hearing, the bankruptcy court entered a memorandum and order on  
7 August 22, 2006, granting the motion on both grounds. The court  
8 held that the Release became effective prepetition and Centre did  
9 not invoke its power of revocation under Article X prior to the  
10 petition date. "Therefore, as of the petition date, the only  
11 claim Centre could have had against SNIG is above \$180 million."<sup>6</sup>  
12 Memorandum of Opinion at pages 12-13.

13 On August 31, 2006, the bankruptcy court entered an order  
14 approving a stipulation granting Centre an extension of time to  
15 September 21 to file a notice of appeal. Centre thereafter filed  
16 its timely notice of appeal.

17 On December 19, 2006, the clerk of this panel issued an  
18

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19 <sup>6</sup> The bankruptcy court noted that Centre was not seeking to  
20 nullify the PCSA under subsections (a) through (d) of Article X,  
21 but was instead attempting to exercise its rights in accordance  
22 with "any other remedy provided by law, equity, statute, or  
23 contract." Memorandum of Opinion at 7. The court held that any  
24 such remedy arose postpetition and thus was unavailable to  
25 Centre. "Centre's postpetition attempt to exercise any remedies  
26 it may be entitled to under [Article] X is beyond the scope of  
27 this memorandum because no legal theory exists (and Centre has  
28 been unable to articulate one) where the postpetition exercise of  
remedies by Centre would somehow impact the prepetition release."  
Id. at 13. Specifically, the court rejected Centre's argument  
that it held a prepetition contingent claim against SNIG and that  
there was a failure of consideration for the release. We  
disagree with the bankruptcy court's conclusion that Centre does  
not hold an allowable contingent claim under section 502(b), as  
explained later in this opinion.

1 order requiring Centre to (1) explain how the order was final,  
2 (2) move for leave to file an interlocutory appeal, or (3) obtain  
3 a certification of finality from the bankruptcy court pursuant to  
4 Federal Rule of Civil Procedure ("FRCP") 54(b) (made applicable  
5 by Rules 7054 and 9014). The bankruptcy court entered its order  
6 directing entry of final judgment pursuant to FRCP 54(b) on  
7 February 14, 2007, and the panel entered an order on April 23,  
8 2007, treating the order on appeal as final.

## 9 **II. ISSUES**

10 (1) Did the Release under the PCSA irrevocably extinguish  
11 Centre's claim against SNIG up to \$180 million or was SNIG's  
12 liability revived to the extent of \$110 million upon Centre's  
13 payment of that amount to the Commissioner?

14 (a) Has a finding or final order triggering the  
15 remedies set forth in Article X been made or entered?

16 (b) If so, is any remedy available to Centre under  
17 which SNIG's liability could be revived?

18 (c) If the triggering event has occurred and a remedy  
19 is available at law, does section 502(b) nonetheless  
20 preclude allowance of Centre's claim?

21 (2) Can Centre, as an unsecured creditor, include in its  
22 proof of claim attorneys' fees arising from a prepetition  
23 contract but incurred postpetition?

## 24 **III. STANDARD OF REVIEW**

25 We review de novo the bankruptcy court's grant of summary  
26 judgment. Marshack v. Orange Comm'l Credit (In re Nat'l Lumber &  
27 Supply, Inc.), 184 B.R. 74, 77 (9th Cir. BAP 1995); Mordy v.  
28 Chemcarb, Inc. (In re Food Catering & Housing, Inc.), 971 F.2d

1 396, 397 (9th Cir. 1992). In reviewing a summary judgment, the  
2 task of an appellate court is the same as a trial court under  
3 FRCP 56 (made applicable by Rule 7056). Hifai v. Shell Oil Co.,  
4 704 F.2d 1425, 1428 (9th Cir. 1983); Gertsch v. Johnson &  
5 Johnson, Fin. Corp. (In re Gertsch), 237 B.R. 160, 165 (9th Cir.  
6 BAP 1999). Viewing the evidence in the light most favorable to  
7 the non-moving party, we must determine for ourselves whether  
8 there was no genuine issue of material fact and whether the  
9 moving party is entitled to judgment as a matter of law. Hifai,  
10 704 F.2d at 1428; see FRCP 56(c).

#### 11 **IV. JURISDICTION**

12 Pursuant to 28 U.S.C. § 157(b)(2)(B), the bankruptcy court  
13 had jurisdiction over the allowance or disallowance of Centre's  
14 claim. As the bankruptcy court certified its order disallowing a  
15 portion of the claim as final under FRCP 54(b) and this panel has  
16 determined that the appeal is final, we have jurisdiction over  
17 the appeal under 28 U.S.C. § 158.

#### 18 **V. DISCUSSION**

##### 19 **A. The Release Did Not Irrevocably Extinguish Centre's Claim** 20 **Against SNIG**

21 Trustee contends Centre cannot invoke its Article X remedies  
22 in the absence of a final order, judgment, or other finding that  
23 the Payment was subject to a preference claim. Trustee further  
24 argues that even if the triggering event (the entry of such an  
25 order) had occurred, Centre is not seeking any relief or remedy  
26 available under Article X. Finally, Trustee asserts that even if  
27 the triggering event had occurred and Centre were seeking relief  
28 available under Article X, Centre could not obtain such relief

1 because section 502(b) does not allow claims arising  
2 postpetition. The bankruptcy court did not address the first two  
3 arguments, as it agreed with Trustee's third argument: Centre's  
4 claim was not allowable because it was based on postpetition  
5 actions to revive a debt that was released prepetition. On de  
6 novo review, we are not persuaded by any of the Trustee's  
7 arguments.

8 **1. The "Triggering Event" Under Article X Has Occurred**

9 Centre contends that when it paid \$110 million in settlement  
10 of the Commissioner's preference action against it, SNIG's  
11 obligations as guarantor were restored in that amount. Centre  
12 does not seek to revive the entire amount of the original  
13 guaranty. Article X of the PCSA requires a court finding or  
14 judgment that the payments made under the PCSA were preferential  
15 before Centre could exercise the remedies available to it under  
16 that section.<sup>7</sup> Article X states that if any court of competent  
17 jurisdiction asserting jurisdiction over the subject matter of or  
18 the parties to the PCSA<sup>8</sup> "enters a final order, judgment, or  
19 other finding that . . . a payment under the PCSA] . . .  
20 constitutes a voidable or preferential transfer, . . . an  
21 improper or disproportionate payment . . . or is otherwise in  
22

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23 <sup>7</sup> As the bankruptcy court stated in its Memorandum of  
24 Opinion, Centre is not attempting to revoke the Release or  
25 declare it null and void under subsections (a)-(d) of Article X.  
26 Rather, it is invoking its other remedies provided by law or  
27 equity which become available under Article X upon entry of a  
28 court order or finding that the Payment was subject to a  
preference claim.

<sup>8</sup> Neither party disputes that the state court had  
jurisdiction as contemplated by Article X.

1 violation of law or subject to a claim or preference," Centre may  
2 declare the PCSA null and void or exercise "any other remedy  
3 provided by law, equity, statute or contract[.]" PCSA, Article X  
4 (emphasis added). According to Trustee, Centre has not obtained  
5 such a court finding or judgment, and thus Centre cannot overcome  
6 the release of SNIG.

7 We disagree. The state court order approving the settlement  
8 agreement between the Commissioner and Centre satisfies Article  
9 X's requirement for a court order or finding. Paragraph F of the  
10 order indicated that the Commissioner was attempting to avoid the  
11 transfers and the order provided that the settlement agreement  
12 was "fully and finally approved." The settlement agreement which  
13 was fully approved specifically stated that the payments by  
14 Centre to the Commissioner "are payments on account of the claims  
15 of the Liquidator [Commissioner] arising from payments asserted  
16 to be preferential transfers." The state court order thus  
17 constituted an order or finding that the PCSA payment was subject  
18 to a preference claim. As a consequence, Article X and its  
19 remedies govern and supersede the release provisions of Article  
20 III.<sup>9</sup> That order acknowledges that the Payment was subject to

21 \_\_\_\_\_  
22 <sup>9</sup> As acknowledged by Centre in its opening brief, the  
23 primary obligors and SNIG "as guarantor" were "released from  
24 liability for up to \$180 million" when the \$163.4 payment was  
25 made to Centre under the PCSA. Appellant's Opening Brief at 13.  
26 Despite this admission, Centre notes on page 17 of its Opening  
27 Brief that the Release did not mention SNIG as guarantor. This  
28 omission is irrelevant. The Release applies to all parents and  
affiliates of the primary obligors, for all liabilities or debts  
whatsoever. PCSA, Article III. Recital 3 of the PCSA states  
that the "Guarantor" [SNIG], the primary obligors (the  
reinsurers) and Centre wish "to fully and finally to [sic] settle

(continued...)

1 the Commissioner's preference claim. Therefore, Centre is  
2 entitled to invoke those remedies available to it under Article  
3 X.

4 **2. Centre's Return of \$110 Million to the Commissioner in**  
5 **Settlement of a Preference Claim Revived Its Guaranty**  
6 **Claim Against SNIG**

7 Article X of the PCSA, entitled "Voidable Transfers,"  
8 governs the rights of Centre in the event payments made pursuant  
9 to the PCSA constituted preferential transfers. Upon entry of  
10 the requisite court order or finding, Centre may exercise "any  
11 other remedy provided by law, equity, statute or contract[.]"  
12 PCSA, Article X (emphasis added). In other words, because the  
13 state court's order was the type of court order contemplated by  
14 Article X, it triggered whatever remedies Centre had at law as a  
15 result of the return of the PCSA payment.

16 Centre argues that under applicable law, SNIG's guaranty  
17 obligation was revived upon and to the extent of the return of  
18 the PCSA Payment. While we located no Ninth Circuit or  
19 California case precisely on point, we agree that the return of a  
20 preferential payment by a creditor generally revives the  
21 liability of a guarantor.

22 As the Tenth Circuit has observed (in dicta), courts "have  
23 recognized, without regard to any special guaranty language, that  
24 guarantors must make good on their guaranties following avoidance  
25 of payments previously made by their principal debtors." Lowrey  
26 v. Mfrs. Hanover Leasing Corp. (In re Robinson Drilling, Inc.), 6

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27 <sup>9</sup>(...continued)  
28 and determine their respective obligations and liabilities."  
PCSA, Recital 3.

1 F.3d 701, 704 (10th Cir. 1993). "Although a surety usually is  
2 discharged by payment of the debt, he continues to be liable if  
3 the payment constitutes a preference under bankruptcy law. A  
4 preferential payment is deemed by law to be no payment at all."  
5 Herman Cantor Corp. v. Cent. Fidelity Bank (In re Herman Cantor  
6 Corp.), 15 B.R. 747, 750 (Bankr. E.D. Va. 1981).

7 The Restatement (Third) of Suretyship and Guaranty and the  
8 Corpus Juris Secundum on Principal and Surety echo these general  
9 principles.

10 When a secondary obligation is discharged in whole or  
11 part by performance by the principal obligor or another  
12 secondary obligor, or by realization upon collateral  
13 securing such performance, the secondary obligation  
14 revives to the extent that the obligee, under a legal  
15 duty to do so, later surrenders that performance or  
16 collateral, or the value thereof, as a preference or  
17 otherwise.

18 Restatement (Third) of Suretyship & Guaranty § 70 (1996).

19 Similarly, the Corpus Juris Secundum provides that if a creditor  
20 is forced to refund a payment to a primary obligor, the  
21 guarantor's liability is revived:

22 [T]o discharge the surety, the payment of the principal  
23 debt or obligation must be valid and binding, and, if  
24 the creditor is forced to refund the payment, the  
25 surety's liability is restored. Thus, a surety is not,  
26 as a general rule, released by a payment that is a  
27 preference under the bankruptcy laws, which the  
28 creditor is obliged to refund.

72 C.J.S. Principal and Surety § 129 (Updated 2007).

Trustee disputes the applicability of the cases that follow  
or recognize the general principle, but cites no case law holding  
the contrary: that the liability of a surety or guarantor is not  
revived by a return of a preferential transfer to a primary  
obligor (or its assigns). Rather, Trustee contends that the

1 general principle is inapplicable because, inter alia, the  
2 repayment of the preference must be involuntary for the principle  
3 to apply. Trustee's contention is based on the assumption that a  
4 return of a payment is "voluntary" if it was made pursuant to a  
5 settlement. We disagree.<sup>10</sup> While Corpus Juris Secundum and the  
6 Restatement do indicate that the repayment must be "forced" or  
7 made "under a legal duty to do so," the Sixth Circuit in Wallace  
8 Hardware Co., Inc. v. Abrams, 223 F.3d 382, 408-09 (6th Cir.  
9 2000), held that when the obligee returns a payment as part of a  
10 settlement of a preference avoidance action, the guarantor is not

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12 <sup>10</sup> A state appellate court recently tackled the issue of  
13 whether a return of a payment pursuant to a settlement  
14 constituted a "voluntary" payment outside the scope of the  
15 Restatement's revival rule set forth in section 70. Because the  
16 case is not published and the local rules of the court prohibit  
citation to its unpublished decisions, we will not cite it. We  
nonetheless agree with its reasoned holding.

17 In that case, like Trustee here, the guarantor argued that its  
18 liability on the guaranty was not revived when the creditor  
19 "voluntarily" returned the payment to the primary obligor in  
settlement of a preference action. Like us, the appellate court  
rejected this argument, stating (emphasis added):

20 [T]his argument misconstrues the nature of  
21 voluntariness. [The creditor/obligee] did not  
22 spontaneously return the money to [the primary  
23 obligor]. It responded to a lawsuit, and entered  
24 lengthy negotiations with [the primary obligor] before  
ultimately reaching a settlement. We do not regard the  
25 settlement as uncoerced. A lawsuit necessarily implies  
a degree of compulsion. A payment made in settlement  
of contested litigation is not truly voluntary.

26 We agree with this analysis of why a return of a payment made in  
27 settlement of a lawsuit is not "voluntary" and of why the general  
28 principles of section 70 of the Restatement (Third) of Surety &  
Guaranty apply here.



1 discharged of his obligation to pay the debt.

2 We find Wallace Hardware persuasive. In that case, the  
3 creditor repossessed inventory of a primary obligor in  
4 satisfaction of the obligor's debt. Thereafter, the obligor  
5 filed for bankruptcy relief and the trustee filed an action to  
6 have the repossession avoided as a preference. The creditor  
7 settled with the trustee and sued the guarantors for the amount  
8 of the debt that remained outstanding upon the creditor's partial  
9 return of the proceeds of its inventory repossession.<sup>11</sup>

10 In holding that the guarantors were obligated to repay the  
11 amounts returned by the creditor to the trustee under the  
12 preference action settlement, the Sixth Circuit stated that  
13 "courts have uniformly held that a payment of a debt that is  
14 later set aside as an avoidable preference does not discharge a  
15 guarantor of his obligation to repay that debt." Id. at 408  
16 (citing cases). The Sixth Circuit also observed that the  
17 repossession operated as an accord and satisfaction, and that "an  
18 accord and satisfaction, like any contract, can be set aside, in  
19 whole or in part, for such reasons as mutual mistake, supervening  
20 illegality, or frustration of purpose." Id.

21 Trustee contends that we should disregard Wallace Hardware  
22 because there the obligations of the guarantors, unlike those of  
23

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24 <sup>11</sup> In Wallace Hardware, the payment made by the primary  
25 obligor was attacked under the Bankruptcy Code's preference  
26 provisions, while the Payment here was alleged to be preferential  
27 under California's Insurance Code. Nonetheless, the general  
28 principle -- that the return of a preferential payment of a  
primary obligor by the obligee revives a guarantor's obligation  
otherwise released by that payment -- should operate with equal  
force whatever preference law applies.

1 SNIG, had not been contractually released by the creditor. This  
2 distinction is not significant because while Article III of the  
3 PCSA did release SNIG, Article X provided Centre with whatever  
4 remedies were available in law upon entry of the requisite court  
5 order or finding. As we have already held, the triggering event  
6 of Article X's remedies occurred when the state court entered the  
7 order approving the settlement agreement. As one of the remedies  
8 available at law permits revival of otherwise released guaranty  
9 obligations upon return of a preferential payment of the primary  
10 obligor, the remedies available under Article X and under law  
11 supersede the release provisions of Article III.

12 Thus, Trustee's reliance on Article III's Release in an  
13 effort to distinguish Wallace Hardware and the other cases is not  
14 convincing, particularly because Trustee's position (unlike that  
15 of Wallace Hardware) would discourage settlement of preference  
16 litigation.<sup>12</sup> It would be a strange result, indeed, if we were  
17 to require Centre to litigate with the Commissioner to the bitter  
18 end, lose, then satisfy a judgment of at least \$163.4 million  
19 before it could revive SNIG's guaranty obligation, particularly  
20 where Article X itself requires merely a finding that the Payment  
21 was subject to a preference claim. Instead, we find Wallace  
22 Hardware's position more persuasive because it does not require  
23 full and costly litigation but instead acknowledges that the  
24 general principle should also apply when the creditor returns at  
25 least a portion of a primary obligor's payment in settlement of a

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27 <sup>12</sup> Trustee has not suggested that Centre could have  
28 defeated the Commissioner's state court action or that the  
settlement was inappropriate.

1 preference action.

2 **3. Section 502(b) Does Not Preclude Allowance of Centre's**  
3 **Claim**

4 Trustee argues that even if Centre's claim against SNIG  
5 could be revived under Article X and applicable law, the release  
6 of Article III was still in effect as of its petition date and  
7 thus Centre's claim was extinguished prepetition and not  
8 allowable under section 502(b). In other words, the claim could  
9 not be revived postpetition, even if the PCSA and other governing  
10 law permitted revival outside of bankruptcy. The bankruptcy  
11 court agreed with Trustee, holding that Centre was attempting to  
12 invoke postpetition remedies and thus asserting postpetition  
13 claims. We hold, however, that Centre held a prepetition  
14 contingent claim inasmuch as the guaranty claim was subject to  
15 revival once the state court conservatorship had begun  
16 prepetition, giving rise to a possible (and foreseen) preference  
17 action by the Commissioner.

18 Section 502(b) provides that a court is to determine the  
19 amount of a prepetition claim "as of the date of the filing of  
20 the petition, and . . . allow such claim in such amount." The  
21 bankruptcy court agreed, concluding because Centre's claims  
22 against SNIG had been released and extinguished as of the  
23 petition date, its claim was disallowed, and section 502(b)  
24 precluded Centre from relying on postpetition events to revive  
25 the claim. Centre argues that its claim for recovery of any  
26 preferential payments it made postpetition constitutes an  
27 allowable contingent claim under section 502(b). We agree;  
28 Centre's claim should not be disallowed merely because the

1 removal of the contingency affecting its claim will occur  
2 postpetition, a consequence that is plainly at odds with the  
3 Bankruptcy Code.

4 A claim is broadly defined under the Bankruptcy Code. It  
5 includes a right to payment or equitable remedy "whether or not  
6 such right is reduced to judgment, liquidated, unliquidated,  
7 fixed, contingent, matured, unmatured, disputed, undisputed,  
8 legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)  
9 (emphasis added). The Code utilizes this "broadest possible  
10 definition" of claim to ensure that "all legal obligations of the  
11 debtor, no matter how remote or contingent, will be able to be  
12 dealt with in the bankruptcy case." Cal. Dep't of Health Servs.  
13 v. Jensen (In re Jensen), 995 F.2d 925, 929-30 (9th Cir. 1993)  
14 (emphasis in original) (citations and quotations omitted).

15 Section 502(b)(1) provides that a claim is not allowable if  
16 it is unenforceable under the applicable agreement or law "for a  
17 reason other than because such claim is contingent or unmatured."

18 11 U.S.C. § 502(b)(1) (emphasis added). Here, the parties  
19 provided in Article X remedies for Centre in the event a court  
20 entered an order or finding that the Payment was subject to a  
21 preference claim. Upon the occurrence of that contingency or  
22 triggering event, Centre would have certain rights and claims  
23 against SNIG. Under section 502(b)(1), those contingent claims  
24 cannot be disallowed simply because the contingency occurred  
25 postpetition.<sup>13</sup> As we stated in a recent decision, we "must find

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27 <sup>13</sup> If SNIG had filed bankruptcy before the primary obligors  
28 had defaulted on the Fronting Agreements and QSR Contract, Centre  
would hold a claim against SNIG even though SNIG's liability was  
(continued...)

1 a basis in section 502 to disallow a claim, and absent such  
2 basis, we must allow it." Wells Fargo Fin. Acceptance v.  
3 Rodriguez (In re Rodriguez), 375 B.R. 535, 545 (9th Cir. BAP  
4 2007), citing Travelers Cas. & Sur. Co. of Am. v. Pacific Gas &  
5 Elec. Co., \_\_\_ U.S. \_\_\_, 127 S.Ct. 1199, 1206 (2007) ("we  
6 generally presume that claims enforceable under applicable state  
7 law will be allowed in bankruptcy unless they are expressly  
8 disallowed" under section 502). Contingent claims are allowed  
9 under section 502(b).

10 Moreover, as the parties concede, federal law determines  
11 when a claim arises under the Bankruptcy Code. Zilog, Inc. v.  
12 Corning (In re Zilog, Inc.), 450 F.3d 996, 1000 (9th Cir. 2006).  
13 "It is well-established that a claim is ripe as an allowable  
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15 <sup>13</sup>(...continued)  
16 contingent on the primary obligors' future postpetition default.  
17 See In re All Media Props., Inc., 5 B.R. 126, 133 (Bankr. S.D.  
18 Tex. 1980), aff'd, 646 F.2d 193 (5th Cir. 1981) ("[I]n the case  
19 of the classic contingent liability of a guarantor of a  
20 promissory note executed by a third party, both the creditor and  
21 guarantor knew that there would be liability only if the  
22 principal defaulted. No obligation arises until such default.").  
Similarly, here, the parties knew that Centre's remedies against  
SNIG under Article X would not be available until the occurrence  
of a contingent, triggering event: the entry of a court order or  
finding that the Payment was subject to a preference claim.

23 Another subsection of section 502 demonstrates that Congress  
24 did not intend for claims to be disallowed simply because of  
25 their contingent nature. Section 502(c)(1) establishes a  
26 procedure for the estimation of such claims by the bankruptcy  
27 court. Even though such claims could not be enforced on the  
28 petition date outside the bankruptcy court, the Bankruptcy Code  
clearly contemplates that the bankruptcy estate will deal with  
contingent and unliquidated claims, including contingent or  
unliquidated guaranty claims against debtors. In re Tiegen, 228  
B.R. 720, 722-23 (Bankr. D. S.D. 1998) (estimating claims of  
holders of guaranties executed by chapter 7 debtors).

1 claim in a bankruptcy proceeding even if it is a cause of action  
2 that has not yet accrued." Cool Fuel, Inc. v. Bd. of  
3 Equalization (In re Cool Fuel, Inc.), 210 F.3d 999, 1007 (9th  
4 Cir. 2000). The Ninth Circuit has adopted the "fair  
5 contemplation" test for determining when a claim accrues for the  
6 purposes of section 502(b). Zilog, 450 F.3d at 1000; Cool Fuel,  
7 210 F.3d at 1007; Jensen, 995 F.2d at 930. Under that test, a  
8 claim arises when a claimant can fairly or reasonably contemplate  
9 the claim's existence even if a cause of action has not yet  
10 accrued under nonbankruptcy law. Cool Fuel, 210 F.3d at 1007.

11 Here, the parties contemplated that Centre could have a  
12 claim against SNIG in the event a payment made by the primary  
13 obligors under the PCSA constituted a preferential transfer.  
14 Article X was drafted to cover that contingency. The Debtors  
15 filed their respective chapter 11 petitions after the  
16 Commissioner placed the primary obligors into conservation. As  
17 the conservation was commenced approximately three months after  
18 the PCSA payments were made, an action by the Commissioner to  
19 recover those payments as preferential could have been reasonably  
20 and fairly contemplated by SNIG and Centre as of the petition  
21 date. See Cal. Ins. Code § 1034(c)(1) (transfers made within  
22 four months before filing of the liquidation/conservation  
23 petition are avoidable). Consequently, those claims accrued  
24 (even if they were contingent and not fixed) as of the petition  
25 date, even if the Release were still effective as of that date.

26 Hence, because Centre's claim based on a revival of SNIG's  
27 guaranty was an allowable claim as of the date of the petition,  
28 we will reverse.

1 B. Centre May Be Entitled to Add Its Postpetition Attorneys'  
2 Fees To Its Unsecured Claim

3 This appeal presents a question currently pending before the  
4 Ninth Circuit: May an unsecured creditor include attorneys' fees  
5 incurred postpetition as part of its unsecured claim? In  
6 Travelers, the Supreme Court did not resolve this issue but  
7 instead remanded it to the Ninth Circuit for resolution.  
8 Travelers, 127 S.Ct. at 1207-08. Rather than delay this appeal  
9 to await that outcome, we will answer the question ourselves.<sup>14</sup>

10 In Travelers, the bankruptcy court had followed the Ninth  
11 Circuit's holding in Fobian v. W. Farm. Credit Bank (In re  
12 Fobian), 951 F.2d 1149 (9th Cir. 1992), that creditors could not  
13 recover attorneys' fees for litigating issues particular to  
14 bankruptcy law and disallowed the claim for such fees by  
15 Travelers. The district court and the Ninth Circuit affirmed.  
16 The Supreme Court reversed to the extent the claim was disallowed  
17 on this ground, overruling Fobian. It specifically refused,  
18 however, to decide whether Travelers' claim for postpetition  
19 attorneys' fees was disallowed under section 502(b)(1) because of  
20 Travelers' status as an unsecured creditor. Travelers, 127 S.Ct.  
21 at 1207-08.

22 Since Travelers was issued by the Supreme Court, two  
23 bankruptcy courts have disagreed on the issue of whether an  
24 unsecured creditor can recover fees incurred postpetition, with a

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26 <sup>14</sup> First, we owe it to the parties to decide cases before  
27 us promptly. Second, our decision is subject to review by the  
28 Ninth Circuit. Third, we believe the Ninth Circuit values the  
views of the Bankruptcy Appellate Panel on bankruptcy issues.  
Sigma Micro Corp. v. Healthcentral.com (In re Healthcentral.com),  
504 F.3d 775, 784 n.3 (9th Cir. 2007).

1 split result.<sup>15</sup> Compare Omect, Inc. v. Burlingame Capital  
2 Partners II, LP (In re Omect, Inc.), 368 B.R. 882 (Bankr. N.D.  
3 Cal. 2007) (unsecured creditor was entitled to include its  
4 contract-based attorneys' fees incurred postpetition in its  
5 prepetition claim) to In re Elec. Mach. Enter., Inc., 371 B.R.  
6 549 (Bankr. M.D. Fla. 2007) (disallowing unsecured creditor's  
7 postpetition attorneys' fees).

8 The split is unsurprising, as the cases decided prior to  
9 Travelers also reached opposite conclusions, with the majority  
10 holding that unsecured creditors could not assert attorneys' fees  
11 incurred postpetition as part of their claims.<sup>16</sup> While the  
12 \_\_\_\_\_

13 <sup>15</sup> In addition, the First Circuit issued a post-Travelers  
14 opinion that favorably cited authority supporting the allowance  
15 of postpetition attorneys' fees to unsecured creditors, but that  
16 decision is not on point. UPS Capital Bus. Credit v. Gencardelli  
17 (In re Gencardelli), 501 F.3d 1, 6 (1st Cir. 2007). The  
18 Gencardelli court was not addressing the issue of postpetition  
19 attorneys' fees but instead held that an oversecured creditor was  
20 entitled to collect a prepayment penalty from a solvent debtor  
21 regardless of reasonableness.

22 <sup>16</sup> In the majority line of cases, courts have held that  
23 unsecured creditors are not entitled to claim such fees, as  
24 section 506(b) is the only provision in the Code that permits the  
25 recovery of postpetition fees from the estate, and that section  
26 applies only to secured creditors. See Adams v. Zimmerman, 73  
27 F.3d 1164, 1177 (1st Cir. 1996); Waterman v. Ditto (In re  
28 Waterman), 248 B.R. 567, 573 (8th Cir. BAP 2000); Pride Cos.,  
L.P. v. Johnson (In re Pride Cos., L.P.), 285 B.R. 366, 372-73  
(Bankr. N.D. Tex. 2002) (collecting cases).

In the sizable minority line of cases, courts have permitted  
unsecured creditors to claim attorneys' fees incurred  
postpetition but based on a prepetition contract. See Martin v.  
Bank of Germantown (In re Martin), 761 F.2d 1163, 1168 (6th Cir.  
1985); United Merchs. & Mfrs. Inc. v. Equitable Life Assurance  
Soc'y of the U.S. (In re United Merchs. & Mfrs. Inc.), 674 F.2d  
134 (2d Cir. 1982) (decided under the former Bankruptcy Act, but

(continued...)



1 holdings may diverge, these cases analyze the four primary  
2 arguments asserted in favor of and against the allowance of such  
3 claims: whether section 506(b) operates to disallow such claims;  
4 whether section 502(b) disallows such claims because they were  
5 not fixed "as of the date of the filing of the petition;" whether  
6 the Supreme Court's decision in United Savings Ass'n of Texas v.  
7 Timbers of Inwood Forest Assocs., Ltd, 484 U.S. 365 (1988),  
8 precludes allowance of such claims; and whether public policy  
9 favors disallowance of such claims. We address each argument in  
10 turn.

### 11 **1. Section 502 vs. Section 506**

12 In Electric Machinery, as in almost all of the cases in the  
13 majority line, the court held that unsecured creditors cannot  
14 recover postpetition fees because the "plain language" of section  
15 506(b) precludes such claims:

16 The emphasized language of section 506(b) demonstrates  
17 the congressional intent to create an exception to the  
18 general rule that claims are to be determined as of the  
19 petition date, exclusive of post-petition interest,  
20 attorneys' fees, and other charges. The use of the  
21 words "to the extent" a claim is oversecured, and  
22 "there shall be allowed" interest and fees, mandates  
23 the conclusion that in all other circumstances,  
24 post-petition interest, attorneys' fees, and charges  
25 shall not be allowed. These courts have concluded that  
26 if Congress intended for unsecured creditors to receive  
27 post-petition attorneys' fees, then it would have done  
28 so explicitly by authorizing unsecured creditors to  
collect fees under section 506(b).

24 Elec. Mach., 371 B.R. at 551, citing Pride Cos, 285 B.R. at 372.

25 In contrast, the Qmect court rejected the argument that section

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27 <sup>16</sup>(...continued)  
28 commenting on section 506(b) of the current Code); In re New  
Power Co., 313 B.R. 496 (Bankr. N.D. Ga. 2004); but see Pride  
Cos., 285 B.R. at 374 (listing the "sizable minority" cases  
decided before 2002).

1 506(b) permits only secured creditors to recover postpetition  
2 fees:

3 The Court finds this reading of 11 U.S.C. §§ 502(b) and  
4 506(b) too strained to be persuasive. First, 11 U.S.C.  
5 § 506 is entitled "Determination of Secured Status." A  
6 statute so entitled would not be a logical place to  
7 provide for the disallowance of an element of an  
8 unsecured claim. If Congress, in enacting the  
9 Bankruptcy Code, had wanted to disallow claims for  
10 post-petition attorneys' fees, the logical place for it  
11 to have done so was surely in 11 U.S.C. § 502(b).  
12 Moreover, 11 U.S.C. § 506(b) does not distinguish  
13 between pre-petition and post-petition attorneys' fees.  
14 Thus, if 11 U.S.C. § 506(b) is read as an additional  
15 ground for objecting to claims, arguably, an unsecured  
16 creditor would be prohibited from including its  
17 pre-petition attorneys' fees in its claim as well as  
18 its postpetition fees.

19 Omect, 368 B.R. at 885.

20 We are not persuaded by the approach of the Electric  
21 Machinery court and, like Omect, we reject the argument that  
22 section 506(b) preempts postpetition attorneys' fees for all  
23 except oversecured creditors. While we cannot predict how the  
24 Ninth Circuit will decide this issue in Travelers, we do find a  
25 clue in Joseph F. Sanson Inv. Co. v. 268 Ltd. (In re 268 Ltd.),  
26 789 F.2d 674, 678 (9th Cir. 1986), where the Ninth Circuit  
27 observed that section 506(b) defines secured claims and does not  
28 limit unsecured claims:

When read literally, subsection (b) arguably limits the  
fees available to the oversecured creditor. When read  
in conjunction with § 506(a), however, it may be  
understood to define the portion of the fees which  
shall be afforded secured status. We adopt the latter  
reading.

26 268 Ltd., 789 F.2d at 678.

27 In 268 Limited, an oversecured creditor sought postpetition  
28 attorneys' fees based on its contract with the debtor, which

1 provided that the creditor could recover five percent of the  
2 balance due at the time of default as attorneys' fees. Id. at  
3 675. The creditor argued that because Nevada law permitted  
4 recovery of fees on such a percentage basis, the fees were  
5 reasonable and allowable under section 506(b) as a matter of law.  
6 Id. The Ninth Circuit disagreed, holding that section 506(b)  
7 permitted the creditor to claim as secured only its "reasonable"  
8 fees and that the percentage recovery was unreasonable. Id. at  
9 675-77. The Ninth Circuit then remanded to allow the creditor to  
10 claim those attorneys' fees exceeding the "reasonable" amount as  
11 an unsecured claim under section 502(b)(1). The court noted that  
12 "other creditors may claim such expenses" under that section and  
13 that section 506(b) does not "limit the fees available" as an  
14 unsecured claim but merely "define[s] the portion of the fees  
15 which shall be afforded secured status."<sup>17</sup> Id. at 678.

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17 <sup>17</sup> While the Ninth Circuit in 268 Limited distinguished the  
18 allowability of claims under section 502(b)(1) (which  
19 incorporates "applicable law" and is silent about  
20 "reasonableness") from the definition of secured claim under  
21 section 506, it is important to note that its determination that  
22 an unsecured claim may be asserted for the amount of fees in  
23 excess of the amount that was "reasonable" under section 506(b)  
24 does not mean that the claim necessarily had to be allowed.  
25 Rather, the court of appeals remanded to allow the creditor to  
26 "seek" the balance of its fees under section 502 and expressed  
27 "no opinion on the enforceability under the governing state law  
28 of the deed of trust's attorney's fees provision." 268 Ltd., 789  
F.2d at 678. In other words, the claim would still be subject to  
objection on the merits based on Nevada law, the precise terms of  
which were not discussed by the Ninth Circuit (although the  
contentions of the creditor suggest that Nevada law did not  
impose a separate reasonableness requirement for recovery of  
contractual attorneys' fees but instead permitted recovery of  
such fees on a percentage basis). In this instance, "applicable"  
California law permits recovery of contractual attorneys' fees  
only if they are reasonable. See CAL. CIV. CODE § 1717. Thus,  
with respect to California cases, "applicable law" limits

(continued...)

1 We agree with the Ninth Circuit, as well as with the  
2 Eleventh Circuit in Welzel v. Advocate Realty Inv., LLC (In re  
3 Welzel), 275 F.3d 1308, 1316-20 (11th Cir. 2001), that the  
4 allowance functions of section 506(b) and 502(b) have been  
5 incorrectly conflated. Section 502(b), which applies to claims  
6 generally, does disallow unmatured interest (see 11 U.S.C.  
7 § 502(b)(2)); it does not specifically disallow attorneys' fees  
8 of creditors or certain other charges. Section 506(b), on the  
9 other hand, specifies what may be included in a secured claim.

10 Comparing the two provisions, the Ninth and Eleventh  
11 Circuits courts have held that a creditor may assert an unsecured  
12 claim for fees and costs arising under its contract with the  
13 debtor, even though the creditor's claim was not an allowed  
14 secured claim under section 506(b). See Welzel, 275 F.3d at  
15 1317-18 (contains a thorough analysis of the two sections and  
16 their respective roles in the Bankruptcy Code).

17 [W]e must determine how to interpret the general  
18 instructions concerning allowance and disallowance  
19 contained in [section] 502 and the more specific  
20 instructions concerning attorney's fees in [section]  
21 506(b) such that the two provisions are rendered  
22 consistent. We first note that [section] 506(b) does  
23 not state that attorney's fees deemed unreasonable are  
24 to be disallowed. In fact, the subsection is  
25 completely silent with regard to the  
26 allowance/disallowance issue. This silence suggests  
27 that [section] 506(b) is meant not to displace the  
28 general instructions laid down in [section] 502, but to  
be read together in a complementary manner.

Id. at 1317; see also In re Tricca, 196 B.R. 214, 219-20 (Bankr.

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17 (...continued)  
postpetition contractual attorney's fees to "reasonable" amounts  
for the purposes of section 502(b)(1).

1 D. Mass. 1996) ("Section 506(b) is not a provision which concerns  
2 itself with claim allowance. Section 506(b) addresses only the  
3 question of what is part of an 'allowed secured claim.' Those  
4 courts which have examined [section] 506(b) in conjunction with  
5 [section] 502 have concluded that [section] 506(b) does not  
6 create additional exceptions to the allowance of claims; rather  
7 it only provides for the classification of allowed claims as  
8 secured or unsecured"); see also Rodriguez, 375 B.R. at 545  
9 (section 502, not section 506, governs the allowance or  
10 disallowance of unsecured claims).

11 Therefore, if section 506(b) is -- as the Ninth Circuit has  
12 hinted -- irrelevant to determining the allowability of an  
13 unsecured claim, we must look to section 502 to determine  
14 allowability. Travelers, 127 S.Ct. at 1206; Rodriguez, 375 B.R.  
15 at 545. As discussed below, section 502(b) does not specifically  
16 disallow such fees. Omect, 368 B.R. at 885; New Power, 313 B.R.  
17 at 509-10.

## 18 **2. Date That The Claim Arose**

19 The Electric Machinery court, like the bankruptcy court here  
20 and many of the pre-Travelers majority courts, disallowed the  
21 postpetition fees of an unsecured creditor because section  
22 502(b) (1) provides that a bankruptcy court "shall determine the  
23 amount of such claim . . . as of the date of the filing of the  
24 petition" and the postpetition fees did not exist as of that  
25 date. Elec. Mach., 371 B.R. at 551; Pride Cos., 285 B.R. at 373.  
26 Because the amount of fees incurred postpetition cannot be  
27 determined or calculated as of the petition date, section 502(b)  
28 purportedly precludes their allowance. Id. We disagree with

1 this approach, as it is inconsistent with the Bankruptcy Code's  
2 broad definition of "claim," which -- as discussed previously --  
3 includes any right to payment, whether or not that right is  
4 contingent and unliquidated. See 11 U.S.C. § 101(5) (A); Omect,  
5 368 B.R. at 884.

6 Here, the parties' execution of a prepetition agreement  
7 containing an attorneys' fees provision gives rise to a  
8 contingent, unliquidated attorney-fee claim. As the New Power  
9 court held: "[w]hen a creditor's right to payment for fees  
10 exists pre-petition, the right to payment constitutes a 'claim,'  
11 within the meaning of § 101(5) (A), albeit an unliquidated,  
12 unmatured claim that may be estimated for purposes of allowance,  
13 if necessary, pursuant to § 502(c)."<sup>18</sup> New Power, 313 B.R. at  
14 508. "So long as the right to collect the fees existed pre-  
15 petition, the fact that the fees were actually incurred during  
16 the post-petition period is not relevant to the determination of  
17 whether the creditor has an allowable pre-petition claim for the  
18 fees."<sup>19</sup> Id.; see also Mfrs. Hanover Trust Co. v. Bartsh (In re  
19

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20 <sup>18</sup> To the extent that we hold that fees incurred  
21 postpetition but arising out of a prepetition contract or  
22 agreement constitute contingent, unliquidated prepetition claims,  
23 describing them as "postpetition fees" may be inaccurate.  
24 Nonetheless, our use of this term is a shorthand means of  
25 describing attorney fees actually incurred postpetition but based  
26 on the debtor's prepetition contract. More to the point, the  
critical events that no doubt relate to a portion of Centre's  
attorneys fees -- the Release, the Payment and the Commissioner's  
conservation -- all occurred prepetition, thus making Centre's  
claim less remote and less contingent.

27 <sup>19</sup> In Keaton v. Boatmen's Bank of Tenn., 212 B.R. 587 (E.D.  
28 Tenn. 1997), vacated as moot, 145 F.3d 1331 (6th Cir. 1998), the  
district court engaged in a thorough analysis of whether fees

(continued...)

1 Flight Trans. Corp. Sec. Litig.), 874 F.2d 576 (indenture trustee  
2 had a "right of payment" for attorneys' fees under prepetition  
3 contract, and thus had an allowable unsecured claim under section  
4 502(b) even though such fees were unknown as of the petition  
5 date).

6 This approach is consistent with the Ninth Circuit's "fair  
7 contemplation" test -- which we discussed in more detail earlier  
8 -- for determining when a claim accrues. Postpetition fees can  
9 be fairly contemplated when the parties have provided for them in  
10 their contracts and thus are contingent claims as of the petition  
11 date. They cannot be disallowed merely because they are  
12 contingent. Omect, 368 B.R. at 884. As stated by one leading  
13 commentator: "In general, if the creditor incurs the attorneys'  
14 fees postpetition in connection with exercising or protecting a  
15 prepetition claim that included a right to recover attorneys'  
16 fees, the fees will be prepetition in nature, constituting a  
17 contingent prepetition obligation that became fixed postpetition  
18 when the fees were incurred." 5 Collier on Bankruptcy

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19  
20  
21 <sup>19</sup>(...continued)  
22 incurred postpetition pursuant to a prepetition claim are  
23 disallowable because they were not fixed "as of the date of the  
24 filing of the petition." Keaton, 212 B.R. at 589-91. Even  
25 though the decision was vacated as moot when the creditor  
26 abandoned its claim for attorneys' fees (145 F.3d at 1331), we  
27 find the analysis of Keaton persuasive. Quoting the bankruptcy  
28 court with approval, the district court held: "While the  
representation may have been performed after the petition was  
filed, [the creditor's] right to collect attorney's fees arose  
out of the contract and is a prepetition claim." Keaton, 212  
B.R. at 591. The creditor "had a prepetition right to collect  
attorneys' fees, *albeit* an unmatured, contingent right; i.e., the  
right was contingent upon the [creditor] actually incurring  
attorneys' fees in collecting the debt." Id.

1 § 553.03[1][i] (15th ed. Updated 2007).

2 Because we hold that attorneys' fees arising out of a  
3 prepetition contract but incurred postpetition fall within the  
4 Bankruptcy Code's broad definition of claim, we reject the  
5 position of the majority line of cases that section 502(b)  
6 precludes such fees.

7 **3. Does Timbers Control?**

8 Like many other courts in the majority line, the Electric  
9 Machinery court concluded that the Supreme Court's holding in  
10 Timbers, 484 U.S. at 380, mandated disallowance of claims by  
11 unsecured creditors for postpetition attorneys' fees:

12 In Timbers, the Supreme Court concluded that because  
13 section 506(b) permitted post-petition interest to be  
14 paid only out of an equity cushion, an undersecured  
15 creditor who had no such equity cushion fell within the  
16 general rule of disallowing post-petition interest.  
17 Courts that rely on Timbers to disallow post-petition  
18 attorneys' fees and costs reason that the rationale  
19 applies equally to the disallowance of post-petition  
20 attorneys' fees and costs to unsecured or undersecured  
21 creditors.

22 Elec. Mach., 371 B.R. at 551.

23 We believe that Electric Machinery's reliance on Timbers is  
24 misplaced. Timbers provided that an undersecured creditor could  
25 not receive postpetition interest on the unsecured portion of its  
26 debt. Timbers, 484 U.S. at 380. This holding is consistent with  
27 section 502(b)(2), which specifically disallows claims for  
28 unmatured interest. Inasmuch as section 502(b) does not contain  
a similar prohibition against attorneys' fees, the comparison  
between the current issue and that presented in Timbers is not  
persuasive. New Power, 313 B.R. at 510 ("there is no exception  
within 502(b) which would prevent the collection of attorneys'



1 fees by a creditor who has a valid nonbankruptcy right to do so"  
2 and neither section 506(b) nor Timbers bars unsecured creditors  
3 from asserting a contractual or statutory claim for attorneys'  
4 fees); see also Gencardelli, 501 F.3d at 6, n.2 (finding Timbers  
5 inapposite because postpetition interest is "made unavailable as  
6 [an] unsecured claim[] by an explicit statutory provision").

#### 7 **4. Public Policy**

8 Finally, Electric Machinery cites policy reasons why courts  
9 should disallow claims by unsecured creditors for postpetition  
10 attorneys' fees; in particular, the court opines that  
11 disallowance of these claims would promote "equality of  
12 distribution" and would prevent individual creditors from  
13 utilizing scorched-earth litigation tactics or absorbing an  
14 inequitable amount of estate assets. Elec. Mach., 371 B.R. at  
15 551-53. In contrast, the court in Omect identifies a different  
16 policy reason for allowance of such claims (i.e., to prevent the  
17 unfairness of a debtor recovering such fees while the creditor is  
18 prohibited from similar recovery). Because we find that the  
19 Bankruptcy Code itself provides the answer to this issue (by not  
20 specifically disallowing postpetition fees), we do not attempt to  
21 reconcile these policy concerns. In the end, it is the province  
22 of Congress to correct statutory dysfunctions and to resolve  
23 difficult policy questions embedded in the statute.<sup>20</sup>

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24  
25 <sup>20</sup> While there is intuitive appeal to the Electric  
26 Machinery court's concern that an overactive creditor could  
27 unfairly run up fees, several factors reduce the potential for  
28 trouble. First, the fee doctrines of many jurisdictions,  
including the general California attorney's fee doctrine that  
applies here, impose requirements in the nature of

(continued...)

1 In summary, we agree with the Omet court that claims for  
2 postpetition attorneys' fees cannot be disallowed simply because  
3 the claim of the creditor is unsecured. Because Centre is  
4 entitled to claim postpetition attorneys' fees as part of its  
5 unsecured claim under section 502, we remand for the bankruptcy  
6 court to determine whether Centre has satisfied the requisites  
7 for allowance of that portion of its claim under the relevant  
8 contracts and state law.

## 9 VI. CONCLUSION

10 For the foregoing reasons, we REVERSE the bankruptcy court's  
11 holding that Centre's claim against SNIG up to the amount of \$180  
12 million be disallowed and REMAND for allowance of the \$110  
13 million paid by Centre to the Commissioner. We further REVERSE  
14 the disallowance of Centre's postpetition fees to the extent the  
15 disallowance was based solely on Centre's status as an unsecured  
16 creditor and REMAND for a determination of whether Centre is  
17 entitled to the fees under the relevant contracts or state law or

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18 <sup>20</sup>(...continued)  
19 reasonableness. Second, the sections of the Bankruptcy Code that  
20 expressly focus on compensation for attorneys generally include  
21 limitations premised on reasonableness: e.g.,  
22 section 303(i)(1)(B) ("reasonable attorney's fee");  
23 section 329(b) ("reasonable value of any such services");  
24 section 330(a) ("reasonable compensation"); section 331  
25 (incorporates section 330); section 502(b)(4) ("reasonable value  
26 of such services"); section 503(b)(4) ("reasonable  
27 compensation"). It is counterintuitive to suppose that a court  
28 of equity would fully allow a claim for creditor's unreasonable  
attorneys' fees in litigating with an attorney who can receive  
only "reasonable" compensation. Third, economic constraints on  
creditors exist in the typical bankruptcy case where resources  
are not available to pay unsecured claims in full; a creditor's  
extra fees will be fully compensated only in the unusual  
situations where funds are available to pay 100 percent of  
claims. Thus, the opportunities for gamesmanship are limited.

1 whether other grounds exist (apart from Centre's status as an  
2 unsecured creditor) for disallowing the postpetition attorneys'  
3 fees claim.

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