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## Claims Chat

BY EDWARD L. SCHNITZER

### Sometimes a Post-Petition Attorneys' Fee Award Is Just a Valueless Post-Petition Claim



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To qualify for an administrative-expense claim under § 503(b)(1)(A) of the Bankruptcy Code, a movant must establish that the expense arose from a transaction with the estate, and that such transaction benefited the estate. The U.S. Supreme Court's *Reading*<sup>1</sup> exception provides a limited exception to the estate-benefit requirement if the movant is able to establish that the claim arose from the wrongful conduct of a receiver/trustee. On Sept. 29, 2022, the U.S. Bankruptcy Court for the Western District of Oklahoma held that the *Reading* exception did not apply to a fee-shifting statutory award of attorneys' fees resulting from post-petition litigation pursued unsuccessfully by a chapter 7 trustee.<sup>2</sup>

#### Greenway Facts

##### Greenway Park Addition Real Estate Plot

In 2012, Greenway Park LLC ("Greenway" or, subsequently, the "debtor") was organized and acquired a plot of real estate called Greenway Park Addition in the City of Norman, Okla. The plot was subject to a 2008 declaration setting forth certain covenants and restrictions. In 2012, the plot was subdivided into seven lots, with Lot 3 being sold to RT Properties LLC and Lot 6 being sold to RT Properties and Rodney Thornton (collectively, "RT").

After the subdivision and sale, Greenway filed an amended declaration purporting to add additional covenants and restrictions for the entire lot, including Lots 3 and 6 (which had previously been sold to RT). In response, RT requested that Greenway

remove the amended declaration because the new covenants and restrictions were encumbering their property. Greenway refused the request.

#### RT/Greenway Litigation

On June 12, 2013, Greenway commenced litigation against RT, which responded by filing counterclaims against Greenway and bringing a separate action that, *inter alia*, sought damages for slander of title, bad-faith breach of contract, negligence and intentional interference with prospective economic advantage. Greenway submitted a claim to its insurance carrier, Nautilus Insurance, for coverage relating to the RT claims under its commercial general liability insurance policy. Nautilus denied the claim on Jan. 23, 2014. In February 2015, a jury returned a verdict against Greenway in the amount of \$500,000. As prevailing parties, RT sought an award of attorneys' fees.

#### Bankruptcy

Due to the jury verdict and RT's pending request for attorneys' fees, Greenway filed a chapter 11 voluntary petition on Aug. 12, 2015. The case was subsequently converted to chapter 7 on Jan. 20, 2016, and Kevin M. Coffey was appointed chapter 7 trustee.

#### Trustee/Debtor Lawsuit

In the spring of 2016, the trustee sought and obtained court approval to retain special counsel, Miller & Johnson PLLC, on a contingency basis to pursue claims against Nautilus and the debtor's insurance broker, Alexander & Strunk Inc. (A&S).<sup>3</sup>

<sup>1</sup> *Reading Co. v. Brown*, 391 U.S. 471 (1968).

<sup>2</sup> *In re Greenway Park LLC*, Case No. 15-13067, Dkt. No. 302 (Bankr. W.D. Okla. Sept. 29, 2022).

<sup>3</sup> *Greenway Park*, Dkt. Nos. 150 and 151.

On June 30, 2016, the Greenway estate, by and through special counsel, filed a lawsuit against Nautilus and A&S in Oklahoma state court, asserting (1) breach of contract for Nautilus’s refusal to provide coverage for the defense of Greenway in the RT litigation, and (2) bad faith for the failure to conduct a thorough, objective and fair investigation of the RT litigation prior to denying coverage. After some limited discovery, Nautilus sought summary judgment.

On Feb. 12, 2019, the Oklahoma state court granted Nautilus’s motion for summary judgment. In affirming that decision, the appellate court held that because Greenway knew of the complaints of encumbrances before the policy period began, and because the acts in question occurred before the start of the policy period, the policy did not cover RT’s claims. Thus, Nautilus had no duty to defend, nor was it bad faith to deny coverage.<sup>4</sup>

### Attorneys’ Fees

Nautilus filed a motion with the Oklahoma state court for attorneys’ fees and costs pursuant to Okla. Stat. tit. 12 §§ 929, 1101.I(B) and tit. 36, § 3629(B) (the “Oklahoma fee-shifting statutes”). On Oct. 8, 2021, the court granted Nautilus’s fee-shifting motion and awarded Nautilus \$369,745.39 (the “fee award”).<sup>5</sup>

### Nautilus Bankruptcy Claims

On Nov. 17, 2021, Nautilus filed Proof of Claim 9-1 in the amount of the fee award, which the trustee objected to as being time-barred due to it having been filed more than four years after the bar date. Nautilus filed a response in support of its claim, asserting that (1) its claim should be treated as a *Reading* administrative-expense claim; (2) the bar date does not apply to the claim because it arose post-petition; and (3) even if the claim is pre-petition, it should have priority under § 726(a)(2)(C) of the Bankruptcy Code.

Simultaneously with its response, Nautilus filed its administrative-expense application (the “Nautilus administrative claim”), seeking payment of the fee award as an administrative expense pursuant to § 503(b)(1)(A) in accordance with the *Reading* exception. Nautilus asserted that an administrative claim was warranted due to the trustee’s post-petition litigation being frivolous.

The trustee opposed the Nautilus response and Proof of Claim 9-1, asserting that (1) Nautilus knew of, or should have known of, the basis for its claim prior to the bankruptcy filing, and thus should have timely filed the claim; and (2) Nautilus did not possess a post-petition claim, as its claim was, at best, a pre-petition claim for attorneys’ fees, “the amount of which was determined post-petition.”<sup>6</sup> In opposing the Nautilus administrative claim, the trustee asserted the following:

1. Any claim that Nautilus possessed was a late-filed pre-petition claim;
2. Administrative expenses are narrowly construed, and allowing this claim would significantly dilute distributions to unsecured creditors;

3. The claim was not administrative because it failed to benefit the estate and was not related to a post-petition transaction;

4. The claim did not qualify under *Reading* because the claim was not a tort claim, it did not arise from conduct undertaken in the operation of the estate’s business, and/or the claim did not arise from frivolous litigation; and

5. The “*Reading* exception does not apply in Chapter 7 cases if the harm is caused by the trustee’s liquidation efforts.”<sup>7</sup>

### Bankruptcy Court Decision

On Sept. 29, 2022, Hon. **Sarah Alexander Hall** of the U.S. Bankruptcy Court for the Western District of Oklahoma issued her decision, which addressed Claim 9-1, the Nautilus administrative claim and the trustee’s objections to both.

### Claim 9-1

First, although the court ultimately granted the trustee’s objection to Claim 9-1, the court disagreed with the basis of the trustee’s objection. The court noted that, while a claim based on a pre-petition breach of contract is typically a pre-petition claim, even if such claim includes post-petition attorneys’ fees, that rule only applies where “the litigation commenced pre-petition.”<sup>8</sup> Here, the fee award was a post-petition claim because it arose from the trustee’s post-petition commencement of litigation against Nautilus “as before that point, the Oklahoma Fee-Shifting Statutes could not have supported a contingency claim.”<sup>9</sup> The fee award did not arise from the underlying contract or the denial of insurance coverage as the trustee had suggested. Nonetheless, the court disallowed Nautilus’s Claim 9-1, because an entity holding only a post-petition claim “cannot be a creditor, cannot file a proof of claim and ... cannot by definition have an allowed claim as of the petition date.”<sup>10</sup>

### The Nautilus Administrative Claim

The court also denied Nautilus’s administrative claim, holding that it did not fit within the *Reading* exception. While explaining that some courts have expanded *Reading*’s “fundamental fairness” doctrine, the Tenth Circuit has interpreted it narrowly, and the “vast majority of cases in this Circuit considering *Reading* found it did not apply.”<sup>11</sup> The court placed significant weight on the fact that the fee award arose from a chapter 7 trustee’s good-faith liquidation efforts, not “from the operation of [the] Debtor’s business.”<sup>12</sup> *Reading* “simply does not apply” to claims arising from a chapter 7 liquidation.<sup>13</sup>

The Nautilus administrative claim also failed because Nautilus did not establish tortious or otherwise wrongful conduct. Instead, while it made “vague claims ... that [the] Trustee’s pursuit of litigation was ‘meritless’ and ‘frivolous,’” Nautilus failed to provide any “evidence ... [that] support[ed] that conclusion.”<sup>14</sup> The court explained that

<sup>7</sup> *Greenway Park*, Dkt. No. 297, p. 11.

<sup>8</sup> *Greenway Park*, Dkt. No. 302, p. 9.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 10 (quoting *In re Ockerlund Const. Co.*, 308 B.R. 331 (Bankr. N.D. Ill. 2004)).

<sup>11</sup> *Id.* at 14.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 16.

<sup>14</sup> *Id.*

<sup>4</sup> The trustee settled with A&S for \$1,350,000. See *Greenway Park*, Dkt. No. 245.

<sup>5</sup> On Oct. 26, 2021, the bankruptcy court granted Miller & Johnson PLLC’s fee application in connection with the firm’s representation of the debtor and the A&S settlement, resulting in fees awarded of \$616,039.89 plus expenses. See *Greenway Park*, Dkt. No. 252.

<sup>6</sup> *Greenway Park*, Dkt. No. 296, p. 17.

neither the fee award order nor the Oklahoma fee-shifting statutes made any mention of frivolous or meritless litigation, leading to the conclusion that “[t]he harm to Nautilus did not arise from any wrongdoing,” a necessary component in order for Nautilus to establish an administrative-expense claim under *Reading*.<sup>15</sup>

Lastly, the court concluded that it was “not fundamentally unfair for Nautilus to bear its own costs of litigation,” as that was consistent with the “American Rule.”<sup>16</sup> On the other hand, if the court were to grant the administrative-claim request, it “would expose any chapter 7 trustee ... to potential administrative expenses ... thus reducing the estate before any other creditors receive distribution.”<sup>17</sup> The court noted that such a possibility “would have a chilling effect on trustees ... pursuing legitimate claims,” and for that reason, the court would not “expand *Reading* to include attorney[s]’ fee awards like the Fee Award held by Nautilus.”<sup>18</sup>

## Conclusion

In the end, Nautilus was left with nothing other than a post-petition claim that was not entitled to any distribution. The *Greenway* decision provides caution to anyone obtaining attorneys’ fees arising from litigation with a chapter 7 trustee. Attorneys’ fees awarded pursuant to a fee-shifting state statute sound good, but they may be worthless in a pending bankruptcy, particularly if the award has no explicit finding of frivolous litigation or similar wrongful conduct. **abi**

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<sup>15</sup> *Id.* at 17; but see *In re Emerald Grande LLC*, Case No. 17-00021 (Bankr. N.D. W.Va. Oct. 7, 2021) (administrative-expense claim awarded for post-petition attorneys’ fees subject to contractual fee-shifting provision).

<sup>16</sup> *Id.* at 17.

<sup>17</sup> *Id.* at 17-18.

<sup>18</sup> *Id.* at 18.