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Supreme Court Holding Allows Bankruptcy Proofs of Claim to be Amended to Recover Attorneys' Fees

Court holds the Bankruptcy Code Does not Prohibit the Recovery of Attorneys' Fees Incurred in Litigating Matters of Bankruptcy Law

On March 20, 2007, the United States Supreme Court issued a unanimous opinion in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, No. 05-1429, 2007 WL 816795 (March 20, 2007), holding that a creditor may supplement its unsecured claim in a bankruptcy case to recover contract-based attorneys' fees incurred during the bankruptcy case through the litigation of bankruptcy law matters.

Case Summary

The case involved attorneys' fees incurred in claim objection litigation between debtor Pacific Gas & Electric Company ("PG&E") and unsecured creditor Travelers Casualty & Surety Company ("Travelers"). Prior to filing a voluntary Chapter 11 bankruptcy petition, PG&E entered into a series of agreements with Travelers whereby Travelers issued a \$100 million surety bond on PG&E's behalf. PG&E sought the surety bond in order to comply with California workers' compensation law. The bond paid up to \$100 million dollars in workers' compensation benefits in the event of a default by PG&E. The agreements between PG&E and Travelers associated with the surety bond included a series of indemnity agreements providing that PG&E was responsible for any loss Travelers might incur in connection with the bonds, including attorneys' fees. Although no default had occurred as of the PG&E petition date, Travelers filed an unsecured claim in the PG&E bankruptcy case to protect itself in the event of a future default. PG&E disputed both the nature of Travelers' claim and how the claim should be described in PG&E's disclosure statement and plan of reorganization. Eventually, the parties entered into a stipulation providing that Travelers could assert its claim for attorneys' fees under the indemnity agreements (subject to PG&E's right to object) as a general unsecured claim against PG&E. Travelers then amended its proof of claim to include the attorneys' fees incurred post-petition in connection with the PG&E bankruptcy proceedings. PG&E argued that Travelers could not recover attorneys' fees incurred post-petition in the litigation of bankruptcy issues. The Bankruptcy Court and District Court agreed. The lower courts relied on the *Fobian* Rule (from *In re Fobian*, 951 F.2d 1149 (9th Cir. 1991)) which prohibits the award of attorneys' fees incurred in litigating issues peculiar to federal bankruptcy law. The Court granted certiorari on the issue of whether the Bankruptcy Code disallows contract-based claims for attorneys' fees solely because the fees at issue were incurred litigating issues of bankruptcy law.

Justice Alito, writing for a unanimous Supreme Court, held that no provision in the Bankruptcy Code specifically prohibits such attorneys' fees, and therefore, an unsecured creditor is not prohibited from recovering contract-based attorneys' fees incurred post-petition. The Court noted that the cases developing and following the *Fobian* Rule failed to identify any textual basis in the Bankruptcy Code requiring disallowance of contractual claims for attorneys' fees incurred in litigating issues of federal bankruptcy law. In making this determination, the Court considered each subsection of section 502(b) of the Bankruptcy Code. The Court held that state law determines whether attorneys' fees fall within the category of "unenforceable claims" under section 502(b)(1). The Court found no evidence that the claim for attorneys' fees was unenforceable under California law. In fact, the Supreme Court noted that the Court of Appeals acknowledged that, in some circumstances, state law permits the payment of such fees. The Supreme Court, therefore, specifically struck down the *Fobian* Rule, holding that there is nothing in the Bankruptcy Code prohibiting an unsecured claim for contractual attorneys' fees incurred post-petition through the litigation of bankruptcy law issues.

The Supreme Court limited itself to striking down the *Fobian* Rule. The Court noted that PG&E argued in its Supreme Court brief that section 506(b) of the Bankruptcy Code categorically disallows unsecured claims for contractual attorneys' fees. PG&E argued that section 506(b) allows attorneys' fees to the extent the claimant is oversecured, and therefore, disallows such fees to the extent the creditor is not oversecured or (like Travelers) completely unsecured. The Court refused to address this issue because it was not raised in the courts below and because the Court granted certiorari on the limited issue regarding the *Fobian* Rule. The Court expressed no opinion on whether section 506(b) disallowed unsecured claims for contractual attorneys' fees.

Implications

The decision in *Travelers Casualty* may have broad-reaching implications for both bankruptcy debtors and creditors. From the debtor's perspective, any litigation of matters with creditors that are party to a contract providing for attorneys' fees may result in a larger unsecured claim by that creditor. From the relevant creditors' perspective, the case may warrant the creation of procedures for routinely amending proofs of claim to account for attorneys' fees incurred in litigating issues during the bankruptcy case. In fact, because the Supreme Court ruled that the Bankruptcy Code has never prohibited such fees, creditors may wish to review old cases to amend their existing proofs of claim to include attorneys' fees. It should be noted, however, that any allowable attorneys' fees will receive a distribution commensurate with the discount provided to all general unsecured claims in the case rather than receiving payment in full of the fees. Also, while the case dealt specifically with contract-based attorneys' fees, the holding may be applied to allow attorneys' fees as unsecured claims in situations where the fees are recoverable under any applicable non-bankruptcy statute. Creditors should also look to any attorneys' fee clauses in their contract forms to make sure that they unambiguously include fees incurred in bankruptcy cases.

A copy of the *Travelers Casualty* case is available at 2007 WL 816795 or by visiting the Supreme Court website at: <http://www.supremecourtus.gov/opinions/06pdf/05-1429.pdf>

Robert D. Albergotti
(214) 651-5613

robert.albergotti@haynesboone.com

Henry Flores
(713) 547-2259

henry.flores@haynesboone.com

Mark X. Mullin
(214) 651-5539

mark.mullin@haynesboone.com

Blaine F. Bates
(713) 547-2100

blaine.bates@haynesboone.com

Sarah B. Foster
(512) 867-8412

sarah.foster@haynesboone.com

Lenard D. Parkins
(713) 547-2008

lenard.parkins@haynesboone.com

Charles A. Beckham, Jr.
(713) 547-2243

charles.beckham@haynesboone.com

Thomas A. Howley
(713) 547-2412

tom.howley@haynesboone.com

John D. Penn
(817) 347-6610

john.penn@haynesboone.com

Doug H. Edwards
(713) 547-2219

doug.edwards@haynesboone.com

Patrick L. Hughes
(713) 547-2550

patrick.hughes@haynesboone.com

Stephen M. Pezanosky
(817) 347-6601

stephen.pezanosky@haynesboone.com

Judith Elkin
(212) 659-4968

judith.elkin@haynesboone.com

Kenric D. Kattner
(713) 547-2518

kenric.kattner@haynesboone.com

Robin E. Phelan
(214) 651-5612

robin.phelan@haynesboone.com

Scott W. Everett
(214) 651-5053

scott.everett@haynesboone.com

Trey A. Monsour
(214) 651-5137

trey.monsour@haynesboone.com

Eric Terry
(210) 978-7424

eric.terry@haynesboone.com