Travelers: 15 Months Later
How Are Attorneys Fees Handled in the Northern District?

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Bay Area Bankruptcy Forum

Panelists:

The Honorable Christopher Klein
(Author of the First 9th Circuit Appellate Decision on *Travelers*)

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Much of these materials are derived from a prior program sponsored by the Insolvency Law Committee, Business Law Section of the State Bar of California entitled "*New Adventures in Fee Collection – Drafting and Enforcing Attorneys' Fee Clauses After Travelers*", whose panelists (and authors) were Lisa Hill Fenning of Dewey Ballantine LLP, Gary Kaplan of Howard Rice Nemerovski Canaday Falk & Rabkin and Michael St. James.

TRAVELERS TODAY

I. WHAT DID *TRAVELERS* DECIDE?

A. Pre-*Travelers* Case Law

Most lower courts have held that unsecured creditors generally cannot recover attorneys' fees incurred post-petition. *See In re Pride Cos.*, 285 B.R. 366, 372 (Bankr. N.D. Tex. 2002) (cataloging cases and describing this as the view supported by "[t]he majority of published opinions").

B. The *Fobian* Rule

In *Fobian v. W. Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), and a long string of related cases, the Ninth Circuit laid down a rule disallowing any recovery of attorneys' fees in litigating pure issues of bankruptcy law, despite the existence of an otherwise enforceable attorneys' fees clause in the contract between debtor and creditor, explaining that:

> Here, litigation involved solely issues of federal bankruptcy law: the Bank sought proper application of Sections 506 and 1225. This was not a traditional "action on the contract." "[T]he question of the applicability of the bankruptcy laws to particular contracts is not a question of the enforceability of a contract but rather involves a unique, separate area of federal law." *Coast Trading*, 744 F.2d at 693.

Id. at 1154.

C. Rejection of *Fobian* Rule

In *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 127 S. Ct. 1199 (Mar. 20, 2007), the United States Supreme Court rejected the Ninth Circuit's *Fobian* Rule.

1. Holding: "[A] claim for attorneys' fees arising in the context of litigating bankruptcy issues must be allowed if valid under applicable state law." *Travelers*, 127 S.Ct. at 1206 (quoting 4 *Collier on Bankruptcy* ¶506.04[3][a], at 506-118 (rev. 15th ed. 2006))

2. Reasoning: Section 502(b) provides generally for allowance of claims filed in bankruptcy cases, unless subject to one of the enumerated bases for objections. The *Fobian* Rule is not such a basis.

3. Overruling: Decisions directly relying on *Fobian* to disallow recovery of attorneys' fees in various contexts presumably are now open to reconsideration as the result of the overruling of *Fobian*.

- *E.g.*, *Am. Express Travel Related Servs. Co. v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1126-27 (9th Cir. 1996) (denying attorneys' fees incurred in objecting to debtor's discharge on bankruptcy law grounds); *In re LCO Enterprises, Inc*., 180 B.R. 567, 569 (BAP 9th Cir. 1995) (denying attorneys' fees to successful preference defendant based on *Fobian* case law*); Hassen Imports P'ship v. KWP Fin. VI (In re Hassen Imports P'ship)*, 256 B.R. 916, 920-23 (B.A.P. 9th Cir. 2000) (denying award of attorneys' fees under state reciprocity statute incurred by debtor in confirming plan over creditor's objection and successfully defending creditor's motion for relief from stay)

D. Unanswered Questions

Under *Travelers*, post-petition attorneys' fees are only allowable to the extent permitted under applicable state law and provided by the contract. But *Travelers* does not answer the key question**:** will attorneys' fees now be available for litigating issues that arise in bankruptcy cases?

1. Kinds of post-petition fees at issue: Travelers sought attorneys' fees incurred in filing and litigating its proof of claim, litigating objections to proposed Chapter 11 plans and related disclosure statements, and monitoring the debtor's bankruptcy case.

2. Undecided – § 506(b) "negative inference" issue: The Supreme Court declined to address and expressly left open the issue of whether unsecured creditors are generally precluded from recovering attorneys' fees by negative implication pursuant to § 506(b), which provides for secured creditors to recover "reasonable" attorneys' fees pursuant to applicable contract, because this argument was not properly raised in the lower courts.

- In *Timbers of Inwood Forest Assocs., Ltd*., 484 U.S. 365 (1988), the Supreme Court held that undersecured creditors are not entitled to post-petition interest under § 506(b), which only permits secured creditors to recover post-petition interest. By analogy, § 506(b), which expressly allows attorneys' fees claims of secured creditors, could be read to disallow post-petition attorney fees for unsecured creditors.

- The Bankruptcy Appellate Panel and one bankruptcy court in the Northern District of California have rejected the § 506(b) argument. *See also In re Dow Corning Corp.*, 456 F.3d 668 (6th Cir. 2006) (finding § 506(b) analysis inapplicable in case of solvent debtor).

- Prior Ninth Circuit authority may be applicable. *In re 268 Ltd*., 789 F.2d 674, 678 (9th Cir. 1986) (holding "that § 506(b) [allowing "reasonable fees" as part of secured claims] preempts the state law governing the availability of attorney's fees as part of a secured claim" by limiting recovery to only such fees as are "reasonable," but stating in dicta that the limitation on the secured portion "does not preclude [the creditor] from seeking the contractual fees in excess of the [allowed secured portion] as an unsecured claim" just as other unsecured creditors may under § 502(b)(1)).

3. Undecided – § 503 "benefit to the estate" issue: Although the case was discussed in oral argument, the Supreme Court did not address *Randolph & Randolph v. Scruggs*, 190 U.S. 533, 23 S. Ct. 710, 47 L. Ed. 1165 (1903).

- In *Scruggs*, an assignee for the benefit of creditors unsuccessfully fought the subsequent bankruptcy adjudication and thereafter sought attorneys' fees under a contract. In declining to allow a claim for post-petition attorneys' fees, the Supreme Court explained that, "We are not prepared to go further than to allow compensation for services which were beneficial to the estate." *Scruggs* is generally viewed as a precursor to § 503(b)(3)'s "substantial contribution" doctrine. For one commentator's view on the relevance of *Scruggs*, *see* McDonald, Kelly, *Unsecured Claims for Contract-Based Attorney's Fees: Fobian Is Dead, But Does Justice Holmes' Decision In Randolph & Randolph v. Scruggs Have Continuing Vitality?* 2007 No. 5 Norton Bankr. L. Adviser 1.

4. Undecided – ultimate issue of allowability: "Accordingly, we express no opinion with regard to whether, following the demise of the *Fobian* rule, other principles of bankruptcy law might provide an independent basis for disallowing Travelers' claim for attorneys' fees." *Travelers,* 127 S. Ct. at 1208.

E. Status of Ninth Circuit Remand Proceedings

Travelers has been remanded to Ninth Circuit. The Ninth Circuit has remanded *Travelers* to the Bankruptcy Court.

II. 16 MONTHS LATER

A. Bankruptcy Appellate Panel for the Ninth Circuit allows attorneys fees

1. *In re Hoopai*, 369 B.R. 506, 511 (BAP 9th Cir. 2007) Travelers "made clear that contract-based fees incurred in the course of litigating issues of federal bankruptcy law may be awarded pursuant to state law."

2. *In re SNTL Corp.* 280 B.R. 204 (BAP 9th Cir. 2007) the BAP squarely held that attorney's fees otherwise allowable under the contract were not disallowed solely because they were incurred post-petition.

- Following the BAP's prior decision in *In re Britt* and *In re Rodriguez*, the BAP perceived *Travelers* as presenting a Supreme Court mandate to allow all claims otherwise allowable, unless they were barred by a specific provision of Section 502.

B. Two Judges in the Northern District allow attorneys fees:

1. Judge Tchaikovsky presented an extensive analysis in *In re QMECT, Inc.*, 368 B.R. 882 (Bankr. N.D. Cal. 2007)

2. Judge Morgan accepted post-petition attorney's fees as having been allowed by *Travelers* in *In re Security National Guaranty, Inc.* 03-55847 (Bankr. N.D. Cal. 8/27/07) (copy attached).

C. Absent some new development or contrary Ninth Circuit decision, one assumes that the Judges of the Northern District of California will allow claims for attorneys fees incurred post-petition to the same extent that the claims would be allowed has the attorneys fees been incurred pre-petition.

THE LEGAL CONTEXT

III. ALLOWABILITY OF ATTORNEYS' FEES UNDER SECTION 506(b)

A. Fees Are Mandatory: When fees are provided for in the underlying agreement, and the creditor is oversecured, allowance of attorneys' fees is mandatory. *In re Dalessio*, 74 B.R. 721, 723 (B.A.P. 9th Cir. 1987).

To be eligible for attorneys' fees under § 506(b), a creditor must satisfy four elements:

(1) the creditor's claim is an allowed secured claim;

(2) the creditor is oversecured;

(3) the fees are reasonable; and

(4) the fees are provided for under the agreement.

Kord Enterprises II, 139 F.3d 684, 689 (9th Cir. 1998); *In re Alpine Group, Inc.*, 151 B.R. 931, 935 (B.A.P. 9th Cir. 1993).

B. Reasonableness: A determination of the reasonableness of the fees is not dictated by the amount that would be allowable under state law but requires an independent review. *In re 268 Ltd.*, 789 F.2d 674, 675-77 (9th Cir. 1986).

1. The bankruptcy court has broad discretion to determine the amount of fees. *Dalessio*, 74 B.R. at 724.

2. The key factors are whether the creditor incurred fees and expenses that fall within the scope of the fee provision in the agreement and whether a similarly situated creditor would have reasonably concluded that the actions should be taken to protect its interests.

3. **Need Not Prevail:** Fact that secured creditor did not prevail under § 1717 does not preclude a recovery under §506(b). *In re McGaw Property Mgmt.,* 133 B.R. 227, 230 (Bankr. C.D.Cal. 1991); *In re Boulders on the River, Inc.*, 169 B.R. 969 (Bankr. D.Or. 1994) (right to fees under § 506(b) and Oregon's equivalent to California Civil Code § 1717).

But see, *In re Hoopai,* 369 B.R. 506, 510 (BAP 9th Cir.) assuming without explanation that the secured creditor must be the prevailing party in order to obtain a fee award under Section 506(b).

IV. ALLOWABILITY OF ATTORNEYS' FEES UNDER CALIFORNIA STATE LAW

A. Automatic Reciprocity for Contractual Attorneys' Fees Provisions

1. American Rule: Each party pays its own attorneys' fees, except where a statute or contract provides otherwise. Cal. Code Civ. Proc. § 1021.

2. Statutory reciprocity: California Civil Code § 1717(a) automatically renders all contractual attorneys' fees clauses reciprocal, regardless of the parties' intent:

> In any action on a contract, where the contract specifically provides that attorneys' fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorneys' fees in addition to other costs.

Cal. Civ. Code § 1717(a) (emphasis supplied).

The statute allows the recovery of attorneys fees by the prevailing party whether or not it is the party identified in the Contract. *Santisas v. Goodin,* 17 Cal. 4th 599, 610-11 (1998)

3. Purpose of statutory requirement of reciprocity: to assure fairness where bargaining positions may have been unequal.

4 State law variations: California's reciprocity rule has parallels in Oregon, Idaho and Hawaii, but does not have any statutory analog under the law of New York and many other states.

B. Reciprocity is Liberally Construed

1. Applies to all actions "involving" contracts: "As long as the action 'involve[s]' a contract it is 'on [the] contract' within the meaning of

Section 1717." *Dell Merk, Inc. v. Franzia*, 132 Cal. App. 4th 443, 455, 33 Cal. Rptr. 3d. 694 (2005).

2. Applies to whole contract: "Where a contract provides for attorneys' fees . . . that provision shall be construed as applying to the entire contract. . . ." Cal. Civ. Code § 1717(a).

3. May apply to nonsignatories: Even nonsignatories may benefit if they are sued on a contract as if they were parties to it, where the plaintiff would be entitled to attorneys' fees should the plaintiff prevail in enforcing the contract.

- "Its purposes require section 1717 be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney's fees should he prevail in enforcing the contractual obligation against the defendant." *Reynolds Metals Co. v. Alperson* 25 Cal. 3d 124, 128, 158 Cal. Rptr. 1, 3 (Cal. 1979)

- *See generally, Wilson's Heating and Air Conditioning v. Wells Fargo Bank,* 202 Cal. App. 3d 1326, 249 Cal.Rptr. 553 (Cal. App. 3rd Dist., 1988) (analyzing the development of § 1717 to encompass non-signatories to the contract).

- *See, e.g., Dell Merk, supra* (general contractor who was sued by intervenor-assignee bank to recover a progress payment in construction litigation was entitled to recover attorneys' fees as the prevailing party, pursuant to an attorneys' fees clause in the loan agreement allowing the bank to recover fees and costs of collection of the note from the borrower who had contracted for construction).

4. Test: If the prevailing party would have been liable for attorney's fees if it lost, it is entitled to fees if it wins. *Hsu v. Abarro*, 9 Cal. 4th 863, 870 (1995). Thus, prevailing party is entitled to fee award where it prevails through a determination that the contract is unenforceable.

5. Applies in federal cases involving California contracts: The Ninth Circuit has held that, "Although Section 1717 limits the court's ability to enforce an attorneys' fees clause to 'any action on the contract,' California courts liberally construe 'on a contract' to extend to any action '[a]s long as an action involves a contract and one of the parties would be entitled to recover attorney fees under the contract if that party prevails in its lawsuit . . ..'" *In re Baroff,* 105 F.3d 439, 442-43 (9th Cir. 1997)

- *Baroff, supra* (reversing denial of attorneys' fees in a nondischargeability action under Bankruptcy Code § 523; bankruptcy court erred in denying fees where debtor successfully defended based upon a prepetition settlement agreement containing an attorneys' fees clause, thus qualifying the proceeding as an "action on the contract").

- *In re Sparkman*, 703 F.2d. 1097, 1099 (9th Cir. 1983) ("the court should apply state law not merely in determining whether a breach of contract occurred, but also in deciding whether to award attorneys fees on the claim.")

6. Applies even when underlying contract is held unenforceable: "[A] party is entitled to attorney fees under [Civil Code] section 1717 'even when the party prevails on grounds the contract is inapplicable, invalid, unenforceable or nonexistent, if the other party would have been entitled to attorneys' fees had it prevailed.' [citations omitted]" *MBNA America Bank, N.A. v. Gorman*, 147 Cal. App. 4th Supp. 1, 54 Cal. Rptr. 3d 724 (2006)

- *MBNA America Bank, supra* (awarding attorneys' fees to credit card holder who successfully opposed bank's petition to confirm arbitration award on ground that mandatory arbitration provision in parties' agreement was unenforceable; card holder was "prevailing party" in action "on the contract," since bank had initiated the arbitration and confirmation proceedings to enforce its rights under the contract).

- *Care Constr. Inc. v. Century Convalescent Center, Inc.*, 54 Cal. App. 3d. 701, 707, 126 Cal Rptr. 761 (1976) (awarding fees to defendant who successfully defended on theory that there was no valid or enforceable lease, because the lessor would have been entitled to attorneys' fees had it prevailed).

7. Applies where a contract remedy has been elected: Electing a contract remedy, when a tort option is available, may allow the party to recover attorneys' fees.

- *Star Pacific Investments, Inc. v. Oro Hills Ranch, Inc.*, 121 Cal. App. 3d. 447, 461, 176 Cal. Rptr. 546, 551 (1981) (awarding fees where party asserted fraudulent inducement in a contract action and sought rescission, as opposed to a tort remedy; proceeding qualified as "an action on the contract").

- *Baroff, supra*, 105 F.3d. at 443 ("An action to avoid or rescind an agreement because of fraudulent inducement…is an action on a contract within the meaning of Section 1717"; citing *Star Pacific, supra*, with approval).

C. Limitations and Exceptions to Reciprocity Under Section 1717(a)

1. No reciprocity nor recovery of contractual attorneys' fees in pure tort actions, *but* § 1717(a) does apply to contractual defenses of tort claims. Fraud and other tort claims do not qualify, but contractually based defenses to tort actions may. Cal. Civ. Code § 1717(a).

- *Gil v. Mansano*, 121 Cal. App. 4th 739, 744, 17 Cal. Rptr. 3d. 420, 424 (2004) (denying fees because a tort claim is not an "action on a contract" within the meaning of § 1717 and the narrow attorneys' fees clause limited

recovery to "actions to enforce" the contract; in contrast, a broader attorneys' fees provision covering "any dispute under the agreement" would be sufficiently broad enough to encompass assertion of contractual defenses to fraud, breach of fiduciary duty and other tort claims).

- *See Baroff, supra*, 105 F.3d at 442 (awarding fees where bankruptcy court was required to determine enforceability of settlement agreement to determine whether the fraud action could proceed; the bankruptcy nondischargeability proceeding was an "action on the contract.")

2. Section 1717 reciprocity does not apply to general indemnification clauses. "An indemnification clause will not give rise to a Civil Code § 1717 contractual claim for an award of attorney fees."

- *Campbell v. Scripps Bank*, 78 Cal. App. 4th 1328, 1336, 93 Cal. Rptr. 2d. 635, 642 (2000) (escrow company's indemnity provision in escrow instructions is not a basis for bank to collect attorneys' fees in dispute with principal).

3. Reciprocity does not override mutual contractual limitations on fee recovery. For example, if a contractual attorneys' fees clause applies only if a lawsuit is filed, that limitation will be given effect.

- *Gil*, *supra*, 121 Cal. App. 4th at 743 (denying attorneys' fees, holding that, "The language 'brings an action to *enforce* the contract' is quite narrow." (emphasis supplied).)

4. Note: Uncertainty Regarding Impact of *Johnson v. Righetti*, 756 F.2d. 738 (9th Cir. 1985). In Johnson, the Debtor sought attorney's fees on a relief from stay motion as the prevailing party under Section 1717. Without referencing *Fobian*, the Ninth Circuit held that relief from stay is not an "action on a contract" (to which Section 1717 would apply) but was an "action on a federal statute" for which there was no applicable exception from the American Rule. It is difficult to see how that rationale could be applied following the rejection of the *Fobian* Rule.

D. Meaning of "Prevailing Party"

1. Prevailing party requirement: Contractually authorized attorneys' fees are awarded to the "prevailing party." Cal Civ. Code § 1717(a).

(a) "The party prevailing on the contract shall be the party who recovered a greater relief in the action on the contract." Cal. Civ. Code § 1717(b)(1).

(b) "The court may also determine that there is no party prevailing on the contract for the purposes of this section." *Id.*

2. Determining the "prevailing party" in complex litigation: The trial court has "wide discretion" to determine the prevailing party, regardless of which party received the greater amount of damages.

(a) Offsetting awards are generally taken into account; the net, rather than gross, recovery is usually the basis for determination of the amount of attorneys' fees.

- See 7 Witkin, California Procedure § 160 (4th ed. 2007); *Independent Iron Works v. Tulare*, 207 Cal. App. 2d 164 (1962) (affirming small amount of attorneys' fees award on the basis that much of the original fee request related to the plaintiff's unsuccessful defense of a cross-claim; lower court had a right to consider all circumstances of litigation, including the entry of partial judgments on both the complaint and the cross-complaint, and the net amount of recovery for plaintiff).

(b) However, monetary recovery may not be determinative, depending upon which party prevailed on the underlying issues of liability.

- *Sears v. Baccaglio*, 60 Cal. App. 4th 1136, 1151 (1998) (where guarantor/plaintiff failed in its attempt to invalidate guarantee but was awarded a partial refund of overpayments made under protest, the defendant/cross-plaintiff nevertheless was the prevailing party on the underlying issue of liability and was entitled to attorneys' fees, despite being the party making the monetary payment).

3. No final judgment required: "The court, upon notice and motion by a party, shall determine who is the party prevailing on the contract for purposes of this section, whether or not the suit proceeds to final judgment." Cal. Civ. Code § 1717(b)(1).

4. No fee recovery upon voluntary dismissal: "Where an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party for the purposes of this section." Cal. Civ. Code § 1717(b)(2).

(a) Policy: recovery by defendant in cases involving voluntary dismissal would encourage plaintiffs to maintain pointless litigation in moot cases to avoid liability for fees.

(b) Recurring issue: How late can one dismiss and avoid liability?

- *See In re Arrow Transportation Company of Delaware*, 224 B.R. 457 (Bankr. D. Or. 1998) (debtor entitled to attorneys' fees even though WARN Act claimants withdrew their claim immediately before debtor's motion for summary judgment was filed, because debtor incurred substantial fees regarding the motion prior to its withdrawal)

E. ***Putting It All Together:*** Judge Morgan's *In re Security National Guaranty, Inc.* opinion, attached, is a remarkable example of putting it all together and reaching a seemingly bizarre result:

1. The Debtor was generally the prevailing party, and after excluding various categories of fees and adjusting for various issues, was awarded $495,018 in fees as the prevailing party pursuant to Section 1717.

2. The Creditor, however, was oversecured and reasonably incurred a substantial portion of its fees, and hence was entitled to a fee award of $320,432 pursuant to Section 506(b).

APPLYING *TRAVELERS*

V. UNRESOLVED ISSUES FOR ATTORNEYS' FEES CLAUSES IN BANKRUPTCY CASES

A. Filing and Responding to Objections to Contract Claims

1. Fees apparently allowable: Attorneys' fees for contract claims objection litigation have been allowed under attorneys' fees clauses, subject to "prevailing party" determination:

- *In re Arrow Transportation Co. of Delaware*, 224 B.R. 457 (Bankr. D. Or. 1998) (debtor was entitled to award of prevailing party attorneys' fees for successfully objecting to labor unions' proof of claim for damages under the WARN Act).

- *In re McGaw Property Management, Inc.*, 133 B.R. 227 (Bankr. C.D. Cal. 1991) (debtor and creditor each awarded prevailing party attorneys' fees with respect to the issues upon which they prevailed; the reasonableness of fees measured by amount actually in dispute, not gross amount of claim)

2. **Application Issue – How to Determine the "Prevailing Party"**: Assume creditor files an inflated claim and trustee prosecutes an objection resulting in claim being allowed in a reduced amount. Who is the prevailing party for purposes of attorneys' fee recovery?

(a) Successful collection of a claim or lien is *not* determinative, where the validity of the claim was not the actual subject of the dispute as to which the fees were incurred.

- In *In re Hoopai* 369 B.R. 506, 511 (BAP 9th Cir. 2007), the Panel held that the debtor was the prevailing party on the disputed issues, thus reversing the creditor's attorneys' fees award: "Neither the validity of Countrywide's

liens nor the prospect for full payment were ever in question" and so the attorneys fees analysis should turn on the secured creditor's unsuccessful motions for relief from stay and objections to the debtor's Chapter 13 Plan.

(b) Courts struggle with application of the "prevailing party" doctrine where only part of claim is disallowed.

- See *In re McGaw Property Management, Inc.*, 133 B.R. 227 (Bankr. C.D. Cal. 1991) (in a split decision regarding an objection to secured claim, court determined that $25,000 and not the full amount of the claim was really at issue, limiting the secured creditor's (unreasonable) contractual attorneys' fees to 50% of $2,000 it won, and limiting the debtor's (unreasonable) "prevailing party" attorneys' fees to 50% of the $15,000 it won).

3. Statutory objections vs. contractual defenses: Should there be a distinction between attorneys' fees incurred in contract-based vs. statutory-based objections to claims?

(a) *Travelers* arguably rejects any such distinction by rejecting the *Fobian* Rule.

(b) Potentially turns on the scope of the contractual attorneys' fees clause; procedural context may also affect outcome:

(c) For example, litigating an objection to a landlord's claim for lease rejection damages based on inadequate efforts to mitigate vs. objection to future rent damages based upon application of the § 502(b)(6) "Landlord's Cap."

i. The statutory objection may not be held to qualify as an "action on the contract," although it certainly "involves" the contract.

ii. **Application Issue**: Assume a landlord unsuccessfully moves to dismiss the bankruptcy case explicitly so as to avoid application of the Landlord's Cap of § 502(b)(6), can the estate seek attorneys' fees as the prevailing party under § 1717? Is it an "action on the contract."

iii. Scope of the contractual provision may be determinative.

B. Determination of Debt Dischargeability

1. Pre-*Travelers*, limited allowability in the Ninth Circuit: The Ninth Circuit has permitted recovery of attorneys' fees incurred as to litigating *contract* issues only, disallowing the portion of fees allocable to litigating whether debt is dischargeable under Section 523, except to the extent the dischargeability litigation is necessary to demonstrate the validity of the debt under state law and the amount that is owing.

- *Renfrow v. Draper*, 232 F.3d 688, 692-95 (9th Cir. 2000) (discussing allowability of attorneys' fees under the guidelines of *Baroff* and *Hashemi*)

- *In re Baroff*, 105 F.3d 439 (9th Cir. 1997) (creditor who prevailed on a "fraudulent inducement" claim under § 523 is entitled to recovery of all reasonable fees because debtor's unsuccessful defense was based upon the enforceability of the settlement agreement that contained the attorneys' fees clause; *Fobian* distinguished on the ground that the fees requested there did not relate to the underlying validity of the claim as a matter of state law)

- *Contrast In re Hashemi*, 104 F.3d 1122 (9th Cir. 1996) (in credit card nondischargeability case, creditor was entitled only to the fees incurred in litigating whether debtor breached its contract under state law)

2. Other circuits generally allow such fees for prevailing *creditors*: Dischargeability proceedings are usually treated as actions on the contract under state law.

- **6th Circuit**: *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163 (6th Cir. 1985) (in § 523(a)(2) action, creditor was entitled to attorneys' fees because it had a contractual right to such fees under state law for enforcement of the promissory note; although Code § 523 eliminated prior express statutory basis under the Act for prevailing creditors to receive attorneys' fees in nondischargeability litigation, it did not eliminate any state law basis for such fees).

- **7th Circuit:** *In re Mayer*, 51 F.3d 670 (7th Cir. 1995), *cert. den*. 516 U.S. 1008 (1995) (a contractual attorneys' fees clause may be enforced by a prevailing creditor in a dischargeability action if the provision is valid under state law)

- **8th Circuit:** *Alport v. Ritter (In re Alport)*, 144 F.3d 1163 (8th Cir. 1998) (creditor was entitled to attorneys' fees incurred in § 523(a)(2) action because contract provides for recovery of reasonable attorneys' fees when prevailing "in any matter" arising under the contract documents) [Note: cited *Fobian* with approval for allowability of fees under state law]

- **11th Circuit**: *TranSouth Fin. Corp. v. Johnson*, 931 F.2d 1505 (11th Cir. 1991) (although § 523 does not provide a statutory basis for creditors' fees, creditor was contractually entitled to any attorneys' fees incurred in efforts to collect the note after a default)

3. However, debtors must satisfy § 523(d) standards: More restrictive federal standard held to override state reciprocity laws.

- *In re Sheridan*, 105 F.3d 1164, 1167 (7th Cir. 1997) (debtor was not entitled to attorneys' fees for successful defense of § 523(a)(2) action because he did not qualify for fees under § 523(d), holding that "this federal action does not qualify as one 'with respect to the contract' under the Florida [reciprocity] statute" and thus state law cannot prevail over express federal statutory standards. Note: A sharp dissent criticizes refusal to honor state reciprocity law).

C. Section 365 Executory Contract Litigation

Fees have generally been awarded to the prevailing party, based upon the statutory requirement to cure defaults and compensate for pecuniary losses pursuant to contract.

- *In re Richard Bullock*, 17 B.R. 438 (BAP 9th Cir. 1982) (lessor's attorneys' fees incurred in adversary proceeding should be paid as part of curing debtor's default on lease and in compensation for lessor's actual pecuniary loss)

- *In re Jet I Center, Inc.*, 344 B.R. 168 (Bankr. M.D. Fla. 2006) (lessor entitled to attorneys' fee award as prevailing party for successfully opposing assumption of the lease on the grounds that it had been terminated pre-petition)

- *In re Shangra-La, Inc.*, 167 F.3d 843 (4th Cir. 1999) (default compensation required to be paid to lessor under § 365(b)(1)(B) in connection with assumption of lease includes amounts provided for under contractual attorneys' fees provision)

D. Preference or Other Avoidance Actions

1. Pre-*Travelers,* not allowed in the Ninth Circuit: Ninth Circuit precedent is presumptively overruled by *Travelers.*

2. *In re LCO Enterprises, Inc.*, 180 B.R. 567, 570-71 (BAP 9th Cir. 1995) (denying attorneys' fees to successful preference defendant who had defended on the ground that the contract was assumed and thus all defaults would have had to be cured in any event; holding, "This litigation was based wholly in bankruptcy law," and "was not an action under the contract which gives effect to the attorneys' fees clause in the contract.")

3. **Issue:**:

   (a) Is a preference or fraudulent transfer lawsuit an "action on the contract"?

   (b) What if defendant successfully defends on the basis of a release that includes an attorneys' fees clause?

E. Other Bankruptcy Proceedings

Little pre-*Travelers* case law regarding fee claims by unsecured creditors for general bankruptcy activities such as:

1. Case monitoring and hearing attendance
2. Motions for relief from stay

Issue: Sequential Motions: What about the secured creditor's strategy of bringing a motion for relief from stay early in a Chapter 11 case to "educate the Judge," expecting that motion to be denied but a subsequent motion to be granted? Do such motions qualify as "actions on the contract"? Are fees for the first motion recoverable because the creditor was ultimately successful?

3. Cash collateral motions

Issue:: Who is the prevailing party in a cash collateral dispute where the debtor gets to use the funds, but the creditor wins substantial budgetary and other restrictions? Is it an "action on the contract"?

4. Objections to plans and disclosure statements

Issue: Are fees related to plan objections allowable? How broad/specific does the contract clause have to be? What is the likely impact on Chapter 11 plan formulation, in view of uncertain amount of claims for attorneys' fees incurred post-petition? Will estimation of contingent and unliquidated attorneys' fee claims under § 502(c) be necessary in all cases?

- *See, e.g., In re Hoopai*, 369 B.R. 506, 511 (BAP 9th Cir. 2007) (reversing and remanding award of fees to oversecured creditor, holding that chapter 13 debtor was actually the prevailing party on motion for relief from stay, motion to sell the real property, and plan confirmation, and thus may have a right to recover fees under *Travelers*).

VI. CAN CREDITORS SET-OFF ADVERSE ATTORNEYS' FEES AWARDS AGAINST THEIR PRE-PETITION CLAIMS?

Statement of the Issue: If the debtor or trustee obtains an award of attorneys' fees under a contract and/or state reciprocity statute, must the creditor separately pay such fees to the estate, or can it set them off against prepetition debt owed by the debtor to the creditor (a better result for creditor)?

A. Set-off Governed by Section 553

Merely "preserves" any right to set-off existing under state law.

B. Contract-based Attorneys' Fees Claims Are Generally Considered Prepetition Claims

The Ninth Circuit has held that attorneys' fees incurred in connection with post-petition litigation relating to prepetition contracts are prepetition claims, not administrative claims, because "the source of the estate's obligation remains the prepetition fee provision." *In re Abercrombie*, 139 F.3d 755, 758 (9th Cir. 1998) (denying prevailing creditor's request to allow post-petition fees as administrative priority claim).

The analysis of the Bankruptcy Appellate Panel in *In re SNTL* relied heavily on concluding that the post-bankruptcy attorney's fees constituted a contingent and unmatured pre-petition "claim" under Section 502.

> *But see In re Delta Air Lines*, 341 B.R. 439, 446 (Bankr. S.D.N.Y. 2006), holding that rejection damages are temporally post-petition and hence can never be offset against prepetition debt owed by the creditor to the debtor.
>
> - "The rejection claim did not "arise" pre-petition in any sense of the word. It did not exist pre-petition either as an actual claim or as a contingent claim, any more than the possibility of some future breach of contract claim can be said to "arise" or exist before the actual breach. Thus, as a matter of temporal fact and as a matter of state law, *there was no claim of [the rejected lessor] against Delta that "arose" pre-petition* to be offset . . .."
>
>   Note: The *Delta* decision has been sharply criticized. Misken, Kenneth *Setoff of Rejection Damages Under § 553: A Strained and Imaginative Interpretation*, 25 Aug Am Bankr. Inst. J. 36 (2006); Linna, Daniel *Contract Rejection Damages May Not Be Eligible for Setoff After All Says Delta Court*, 25 Sep Am Bankr. Inst. J. 1 (2006)

C. Permitting Set-off is Always Discretionary

"Section 553, however, is permissive, not mandatory." It is an "equitable remedy", which the court is free to deny. *In re Cascade Roads, Inc.* 34 F.3d 756, 762-3 (9th Cir. 1994)

> 1. Policy concerns: As a matter of policy, courts have refused to allow the offset of a § 303(i) award of damages and attorneys' fees in favor of an involuntary debtor against the petitioning creditor's claim.
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> - *In re K. P. Enterprise*, 135 B.R. 174 (Bankr. D. Me. 1992) (detailed analysis of policy issues)
>
> - *In re Schiliro*, 72 B.R. 147 (Bankr. E.D. Pa. 1987) (notes policy issue, but incorrectly concludes that the attorneys' fee award is payable to the debtor's attorneys and hence there is no mutuality).

2. Specific policy issues: As a matter of policy, an attorneys' fee award to the debtor in Truth-in-Lending litigation cannot be offset against the creditor's claim.

- *Plant v. Blazer Financial Services, Inc*. 598 F.2d 1357 (11th Cir. 1979) (detailed analysis of policy issues).

- *In re Garner*, 556 F.2d. 772 (5th Cir. 1977) (approving result without analysis).