No. 05-1429

IN THE
Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether in bankruptcy cases a litigant may recover attorneys' fees arising under a contract or state statute where the issues litigated involve matters of federal bankruptcy law.

PARTIES TO THE PROCEEDING

Petitioner is Travelers Casualty & Surety Company of America ("Travelers"), as Administrator for Reliance Insurance Company for itself, as successor-in-interest by merger with United Pacific Insurance Company, and for related Reliance Insurance Companies. Travelers is owned by Travelers Home Insurance Group Holdings, Inc., which, in turn, is owned by Travelers Property Casualty Corp., which in turn is owned by The St. Paul Travelers Companies, Inc. The St. Paul Travelers Companies, Inc. is a publicly traded company. Respondent is Pacific Gas and Electric Company ("PG&E").

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PRELIMINARY STATEMENT

This matter arises out of the chapter 11 bankruptcy case of respondent Pacific Gas & Electric Company ("PG&E" or "Respondent"). Before PG&E commenced its bankruptcy case, Petitioner Travelers Casualty & Insurance Company ("Travelers" or "Petitioner") issued surety bonds on PG&E's behalf to various third parties, and PG&E executed a series of indemnity agreements in favor of Travelers. Among other things, the indemnity agreements provide that PG&E is responsible for any loss that Travelers may incur in connection with the bonds, including any attorneys' fees incurred in pursuing, protecting, or litigating Travelers' rights in connection with the bonds.

During PG&E's bankruptcy case, Travelers incurred attorneys' fees in the course of asserting its rights, objecting to its treatment under PG&E's chapter 11 plan and disclosure statement, and defending litigation that PG&E brought against Travelers in connection with the bonds. The relevant proceedings and litigation involved questions of federal bankruptcy law. Travelers filed a claim against PG&E for its attorneys' fees.

Adhering to its prior decision in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), the Ninth Circuit held that Travelers could *not* have a claim for its attorneys' fees as a matter of law. The court reasoned that, although parties may be free to contractually allocate between them the burden of attorneys' fees incurred in litigating *state* law issues, they cannot do so with respect to litigating *federal* bankruptcy issues unless federal law specifically authorizes the allocation. Incorporating by reference its reasoning in *DeRoche v. Ariz. Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006), *reh'g denied*, No. 04-15258 (9th Cir. Feb. 8, 2006),[1] the Ninth Circuit determined that, even if a litigant has a general right to attorneys' fees under applicable state law, either by virtue of a contract valid under state law or by virtue of a state statute, the

[1] A petition for writ of certiorari was filed in the *DeRoche* case and remains pending. Case No. 05-1439.

litigant's general right to fees cannot extend to fees incurred in litigating *bankruptcy* issues because federal law does not *authorize* such a recovery. Significantly, no federal statute directs or requires this result. Instead, the court applied its rule as a matter of general federal common law.

This Court should reverse the decision below for each of seven reasons. First, the *Fobian* rule has the analysis exactly backwards by requiring that federal law must *authorize* a contractual allocation of attorneys' fees in order for Travelers to hold a "claim" for its fees in bankruptcy. As this Court has explained, a creditor (such as Travelers) holds a claim for its attorneys' fees in bankruptcy if its contractual right to the fees is valid under applicable *state* law. Here, Travelers' contractual right to its attorneys' fees is valid under California law. Travelers therefore holds a "claim" for its fees for bankruptcy purposes, 11 U.S.C. § 101(5), and the proper question is whether some provision of the Bankruptcy Code expressly *disallows* Travelers' otherwise valid claim based on its state-law right, 11 U.S.C. § 502. Because no provision of the Code disallows Travelers' claim for its fees, the claim should have been allowed, and the Ninth Circuit's denial of Travelers' claim is contrary to the express requirement of the Code that a claim "shall" be allowed unless one of the *express* grounds for disallowance applies. 11 U.S.C. § 502(b).

Rather than follow this established analysis, the Ninth Circuit's *Fobian* rule creates a federal common law standard that categorically denies the validity of any contractual allocation of attorneys' fees arising from the litigation of bankruptcy issues. This is wrong. There is no general federal common law of bankruptcy governing contractual allocations of attorneys' fees, and there is no basis to conclude that bankruptcy law pre-empts state law on the question whether a party may contractually allocate attorneys' fees arising from litigation involving bankruptcy issues. Contract issues generally, and contractual allocations of attorneys' fees specifically, are governed by state law. Again, if a creditor has a contractual right to attorneys' fees that is valid under state law, the creditor holds a bankruptcy "claim" for its fees. Where, as here, no provision of the

Bankruptcy Code disallows the claim, it must be allowed in the debtor's bankruptcy case.

Second, and closely related to the first reason, the *Fobian* rule conflicts with this Court's precedents restricting the ability of the federal courts to prescribe the categorical treatment of claims in bankruptcy. As this Court has held, it is for Congress, not the courts, to define how state-law rights to payment are to be treated in bankruptcy cases. The *Fobian* rule usurps Congress's authority by concluding categorically that *no* right to attorneys' fees may be recognized in bankruptcy if the fees are incurred in the context of litigating federal bankruptcy issues.

Third, the *Fobian* rule is contrary to the historical treatment of claims for attorneys' fees in bankruptcy proceedings. Following this Court's decision in *Security Mortgage Co. v. Powers (In re Florida Furniture Co.)*, 278 U.S. 149, 154 (1928), courts applying the provisions of the statutory predecessor to the current Bankruptcy Code correctly allowed in bankruptcy cases claims for attorneys' fees incurred in pursuing bankruptcy litigation. *E.g.*, *United Merchants & Mfrs., Inc. v. Equitable Life Assurance Soc'y (In re United Merchants & Mfrs., Inc.)*, 674 F.2d 134, 137-140 (2d Cir. 1982). Because there is no reason to conclude that Congress intended to alter this historical practice, the Court should conclude that it endures.

Fourth, the *Fobian* rule is contrary to the policies and purposes of the Bankruptcy Code. A key bankruptcy policy is equality of distribution, implemented primarily through the Code's pro rata distribution procedures. Absent some express provision of the Code to the contrary, creditors' holding contractual rights to payment for attorneys' fees are no less entitled to receive pro rata distributions on account of their claims than other creditors who hold different kinds of claims. A common law rule of disallowance untethered to any express provision of the Code obviously denies equality of distribution to the holders of claims for attorneys' fees by effectively reducing their distributions to zero.

Fifth, the *Fobian* rule is impractical. It recognizes that, if the creditor's attorneys' fees relate to the litigation of *state* law issues,

a contractual right to attorneys' fees will be allowed as a valid claim in bankruptcy. It is only if the fees relate to the litigation of *federal* bankruptcy issues that the creditor cannot hold a claim. But most litigation in the bankruptcy courts involves consideration of a combination of issues of state and federal law, and it is often impractical to separate fees arising from the litigation of one issue versus the other if they occur in the same proceeding. There is no reason to conclude that Congress intended to burden the courts with the administrative quagmire of sorting fee claims on this basis.

Sixth, the *Fobian* rule leads to absurd results, as illustrated by the *DeRoche* case that the Ninth Circuit decided in tandem with the decision below. In *DeRoche*, the *debtors* asserted a claim for their attorneys' fees against an agency of the State of Arizona under a state statute that rendered the agency liable for the DeRoches' fees arising from the agency's unsuccessful litigation against the DeRoches in federal bankruptcy court. The litigation involved questions of bankruptcy law. Applying *Fobian*, the court ruled that a claim for attorneys' fees arising from the litigation of bankruptcy issues is not valid unless authorized by federal law, and the court denied the DeRoches' claim. The court's application of the *Fobian* rule in the *DeRoche* case yielded the absurd result that a State is barred from directing that its own agency must pay the attorneys' fees incurred by two of its citizens when the agency unsuccessfully sues them in federal court.

Seventh, the *Fobian* rule is inequitable. In general, commercial parties are free to allocate the burden of attorneys' fees contractually, and those that do price their goods and services accordingly. The *Fobian* rule categorically eviscerates this market practice, apparently for the sake of attempting to "equalize" treatment among creditors generally. But "[e]quality among creditors who have lawfully bargained for different treatment is not equity but its opposite," *Chemical Bank v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) (Friendly, J., concurring), and the wholesale elimination of a right to attorneys' fees as part of a creditor's claim is nothing more than an inequitable discrimination.

The *Fobian* rule is an impermissible intrusion upon the text, structure, history, and purpose of the Bankruptcy Code, and an unwarranted federalization of contractual rights. For all the foregoing reasons, this Court should reverse the decision below.

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. 1a, is unpublished, but can be found at 2006 WL285977 (No. 04-15605) (9th Cir. Feb. 7, 2006). The opinion of the district court, Pet. App. 4a, is also unpublished, as is the opinion of the bankruptcy court, Pet. App. 20a.

JURISDICTION

The court of appeals entered its judgment on February 7, 2006. Petitioner timely filed its petition for writ of certiorari on May 8, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS OF LAW

The following statutory provisions and rules are relevant to this matter:[2] 11 U.S.C. §§ 101(5), (12); 501; 502; 509; 1125; and FED. R. BANKR. P. 3003.

STATEMENT OF THE CASE

A. Travelers' Issuance Of Surety Bonds On PG&E's Behalf And PG&E's Execution Of The Indemnity Agreements

For many years prior to PG&E's bankruptcy filing, Travelers issued a variety of surety bonds on PG&E's behalf to various third parties, assuring PG&E's performance of a broad variety of obligations. These bonds include the $100 million surety bond ("Bond") involved in this matter that Travelers issued on PG&E's behalf to the State of California, Department of Industrial

[2] The full text of these statutory provisions and rule appears in the appendix accompanying the petition for writ of certiorari. Pet. App. 27a.

Relations. Supplemental Joint Appendix ("SJA") 6.[3] The Bond assured PG&E's payment of workers' compensation benefits to PG&E's injured employees.

Historically, the State of California required companies such as PG&E to assure the payment of workers' compensation benefits in one of two basic ways: (1) by purchasing workers' compensation insurance; or (2) by meeting certain "self-insurance" requirements. To qualify for "self-insurance," a company such as PG&E was obligated, among other things, to post security with the State, including one or more surety bonds, assuring the payment of mandatory workers' compensation benefits. CAL. LABOR CODE §§ 3700 & 3701(e) (West 2003). The State conditioned PG&E's ability to conduct business as a self-insured employer on its posting of adequate workers' compensation bonds. Had PG&E failed to do so, it would have been required to purchase insurance, which typically costs many times the expense of a surety bond, or cease operations.

In connection with Travelers' agreement to issue bonds on behalf of PG&E (including the $100 million workers' compensation Bond), PG&E executed indemnity agreements in favor of Travelers. Specifically, PG&E executed a Continuing Agreement of Indemnity dated June 11, 1992, and a Continuing Agreement of Indemnity dated June 6, 1991 (collectively, the Indemnity Agreements"). SJA 4, 9-17. Under the terms of these agreements, PG&E is obligated to indemnify Travelers in full for any loss that Travelers may sustain in connection with the bonds. *Id*. The agreements are worded broadly, and include a provision that PG&E is obligated to reimburse Travelers for any and all attorneys' fees that Travelers incurs in connection with the bonds, including any of Travelers' efforts to enforce or protect its rights with respect to the bonds:

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[3] The Bond was issued originally by The Reliance Insurance Company ("Reliance"). Travelers subsequently became the administrator for Reliance. Travelers also issued surety bonds on behalf of PG&E.

> NOW, THEREFORE, in consideration of the execution of any [of the surety bonds] . . . we, the Undersigned [PG&E], agree and bind ourselves . . as follows . . . [to] indemnify, and keep indemnified, and hold and save harmless the Surety [Travelers] against all demands, claims, loss, costs, damages, expenses and attorney's fees whatever and all liability therefor, sustained or incurred by the Surety [Travelers] by reason of executing . . . [the Bonds] . . . or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, . . . recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein contained.

SJA 9,13 ¶ "SECOND."

The fundamental concept behind this broad indemnity provision is to ensure that any loss that Travelers might sustain in connection with the bonds would be borne by PG&E, rather than Travelers. As explained below, this is fundamental to the suretyship relationship -- that the party on whose behalf the surety issues its bond is responsible for holding the surety harmless for any and all loss. Among other reasons, to the extent that sureties are required to bear unreimbursed losses in connection with their bonds, this will inevitably increase the cost of issuing bonds and either make them more expensive or less available, harming industries that rely on surety bonds to conduct their businesses.

B. PG&E's Bankruptcy Filing And Travelers' Proof Of Claim

On April 6, 2001 (the "Petition Date"), PG&E filed a petition for relief under chapter 11 of the Bankruptcy Code. By operation of law, when a debtor commences a bankruptcy case, a bankruptcy estate is created consisting of all of the debtor's property wherever located. 11 U.S.C. § 541. In chapter 11 cases, a trustee is not usually appointed, and the debtor typically continues to manage its business as the "debtor in possession" of the bankruptcy estate. 11 U.S.C. §§ 1101(1) (defining "debtor in possession" in a chapter 11 case), 1107 (prescribing duties of debtor in possession, including

duties of trustee), 1108 (authorizing operation of business). Consistent with these provisions, PG&E continued in possession of its property, and continued to conduct its business, following its bankruptcy filing.

Shortly after the Petition Date, PG&E obtained an order from the bankruptcy court authorizing, but not obligating, it to continue paying workers' compensation benefits. Joint Appendix ("JA") 24a. Because the order only *authorized* PG&E to pay benefits, it did not ensure that PG&E would, in fact, continue to pay benefits to its injured employees, and the order did not bind PG&E to continue paying benefits after it emerged from bankruptcy (only PG&E's confirmed plan could bind PG&E in that fashion). In other chapter 11 cases in which the debtor has been authorized at the beginning of its case to pay workers' compensation benefits, the debtor has discontinued doing so during the course of the case, requiring the surety to pay the relevant benefits under its bond. *See Aetna Cas. & Sur. Co. v. Clerk of U.S. Bankruptcy Court (In re Chateaugay Corp.)*, 89 F.3d 942, 945-46 (2d Cir. 1996) (noting that, in spite of obtaining bankruptcy court authorization to continue paying workers' compensation benefits, the debtor stopped paying during the course of its case and the surety was required to pay $38 million to cover the debtor's obligations).

Under the Bankruptcy Code, all pre-petition rights to payment against the debtor constitute "claims" against the debtor's bankruptcy estate. 11 U.S.C. § 101(5); *Cohen v. De La Cruz*, 523 U.S. 213, 218 (1998) ("a 'claim' is defined . . . as a 'right to payment,' . . . and a 'right to payment,' we have said, 'is nothing more nor less than an enforceable obligation'") (quoting *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990)).[4] Any creditor holding a pre-petition claim, whether contingent or otherwise, is entitled to file a "proof of claim" with the bankruptcy court. 11 U.S.C. §§ 101(5), 101(10), 501(a), 502(b); FED. R.

[4] The term "pre-petition" refers to rights or events arising or occurring *before* the debtor files a bankruptcy petition. The term "post-petition" refers to rights or events arising or occurring *after* the debtor files.

BANKR. P. 3001, 3002; *see Katchen v. Landy*, 382 U.S. 323, 336 (1966) ("bankruptcy . . . converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*").[5] Only creditors who file proofs of claim (or whose claims are scheduled and listed by the debtor as undisputed) may receive distributions from the debtor's bankruptcy estate. FED. R. BANKR. P. 3002(a), 3003(b), (c)(2); *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933).

Shortly after PG&E commenced its bankruptcy case, the bankruptcy court established a "bar date" setting a deadline for the filing of proofs of claim against PG&E. FED. R. BANKR. P. 3003(c)(3). A bar date is significant because a creditor who fails to file a proof of claim by the deadline is generally not entitled to vote on the debtor's chapter 11 plan of reorganization and may not receive any distributions from the debtor on account of any claim the creditor may have. FED. R. BANKR. P. 3003(c)(2).

Although at the time of the "bar date" Travelers had not been called upon to make any payment under the Bond, Travelers was nonetheless obligated to file a proof of claim if it wanted to preserve its rights with respect to its outstanding $100 million Bond. By virtue of the Indemnity Agreements and Travelers' rights as a surety, Travelers held a pre-petition contractual indemnity claim against PG&E for any loss that Travelers might sustain in connection with the Bond, including a pre-petition contractual right to any attorneys' fees that it may incur in connection with the bonds. Under the Bankruptcy Code, Travelers' pre-petition contractual claims were "contingent" in the sense that they were "contingent" upon Travelers actually incurring any loss at a future point in time, such as by having to pay workers' compensation benefits in the future, or by incurring attorneys' fees in the future in connection with enforcing or protecting its rights. Although contingent, Travelers' pre-petition contractual right to payment properly constitutes a claim because

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[5] The Bankruptcy Code defines "creditor" as a person holding a claim that arises before the debtor commences a bankruptcy case. 11 U.S.C. § 101(10).

the Bankruptcy Code expressly includes in the definition of "claim" any "right to payment, whether or not such right is . . . contingent." 11 U.S.C. § 101(5). As courts have long recognized, a proof of claim of this type (i.e., involving contingent claims) must be timely filed in the debtor's bankruptcy case or the creditor will be forever barred from recovering any amount from the debtor if the contingency ripens later. *Employee Ret. Corp. v. Osborne (In re THC Fin. Corp.)*, 686 F.2d 799, 802, 804 (9th Cir. 1982) (creditor who failed to file proof of contingent claim was barred from recovery).

The purpose of the bar date rule and the Bankruptcy Code's broad definition of the concept of a "claim" is to ascertain all of the debtor's liabilities, whether contingent or otherwise, in order to address them comprehensively in the bankruptcy proceeding. Accordingly, a creditor such as a surety who may have to make payment to a third party in the future on account of a pre-petition surety bond must file a proof of claim setting forth its pre-petition contingent contractual right to payment against the debtor arising from the bond even though the surety has not yet made any payment or otherwise incurred any loss. Similarly, if a creditor has a pre-petition contractual right to attorneys' fees, but has not yet incurred the fees at the time the debtor files its bankruptcy case, the creditor must nonetheless file a proof of claim establishing its contingent claim based on its pre-petition contractual right. Consistent with these requirements, on or about September 5, 2001, Travelers timely filed a proof of claim attaching copies of its contractual agreements with PG&E. SJA 1-17.

In its proof of claim, Travelers explained briefly its rights as a surety. First, Travelers explained that, in the event it must ever pay benefits under the Bond, Travelers has a right of indemnification against PG&E. SJA 3-4. Under applicable law, surety bonds are not policies of insurance; they are secondary obligations. *Nat'l Tech. Sys. v. Superior Court of Los Angeles County*, 118 Cal. Rptr. 2d 465, 477 (Cal. Ct. App. 2002). Accordingly, in the event that a surety (here Travelers) incurs any loss in connection with its bond, the surety is entitled to recover its loss from its principal (here PG&E). *Howco Leasing Corp. v.*

Alexander Dispos-Haul Sys., Inc. (In re Alexander Dispos-Haul Sys., Inc.), 36 B.R. 612, 616 (Bankr. D. Or. 1983) (the surety is entitled "to compel the principal debtor to repay immediately all or any part of the principal debt which the surety has paid"). This right exists independently of any contractual arrangement. *See* 74 AM. JUR. 2D SURETYSHIP, § 182 (1974) ("Where the surety has satisfied [its obligation], the principal is bound to indemnify him, irrespective of any express contract of indemnity."). In this case, as noted, the Indemnity Agreements specifically provide for Travelers' right of indemnity.

Second, Travelers explained that, in the event that it must pay benefits under the Bond, Travelers also has a right of subrogation. SJA 4. The doctrine of subrogation entitles a surety to "step into the shoes" of the persons whom the surety pays (here the injured workers) in order to assert *their* claims against the principal (here PG&E). CAL. CIV. CODE § 2848 (West 2003) ("A surety, upon satisfying the obligation of the principal, is entitled to enforce every remedy which the creditor then has against the principal to the extent of reimbursing what he has expended."); *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 138 (1962) (subrogation permits a performing surety to "protect itself by resort to the same securities and same remedies which had been available to the [party whom the surety has paid] for its protection"); *Allen v. See (In re Simmons)*, 196 F.2d 608, 610 (10th Cir. 1952) ("It is well settled that where one secondarily liable is called upon to make good on his obligation and pays the debt, he steps into the shoes of the former creditor [and] becomes subrogated to all the rights of the creditor against the principal debtor."). Thus, under the doctrine of subrogation, in the event that Travelers were ever called upon to pay workers' compensation benefits to PG&E's injured employees, Travelers would have the right to step into the shoes of the workers and assert their compensation claims against PG&E in order to recover whatever amounts Travelers pays. [6]

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[6] The surety's right of subrogation is preserved in bankruptcy. 11 U.S.C. § 509(a). A right of subrogation is not itself a "claim" against the debtor,

Under the Bankruptcy Code, in the event a creditor (such as an injured employee) fails to file a proof of claim, the surety who is obligated under its bond to pay the creditor on the debtor's behalf may file the claim in the creditor's stead. 11 U.S.C. § 501(b). In this case, Travelers, in addition to filing a claim for itself, also filed a claim on behalf of all of the workers who hold workers' compensation claims against PG&E and whom Travelers might someday have to pay. SJA 5. By doing so, Travelers protected both the rights of the employees *and* its own interests.

C. Travelers' Objections To PG&E's Disclosure Statement

During its bankruptcy case, PG&E filed a disclosure statement ("Disclosure Statement") describing its proposed chapter 11 plan of reorganization ("Plan"). 11 U.S.C. § 1125 (stating requirements for a disclosure statement). The purpose of a disclosure statement is to provide creditors with information regarding the proposed treatment of their claims and rights. *Prudential Ins. Co. of Am. v. Monnier (In re Monnier Bros.)*, 755 F.2d 1336, 1342 (8th Cir. 1985) ("The primary purpose of a disclosure statement is to give the creditors the information they need to decide whether to accept the plan."). Travelers objected to PG&E's Disclosure Statement

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but rather constitutes the surety's right to take assignment of the claim of the party whom the surety pays (here the injured workers to whom Travelers may pay benefits). *In re Bessemer Materials, Inc.*, 225 F. Supp. 314, 318 (N.D. Ala. 1963) ("subrogation . . . is merely a form of assignment by operation of law"). Through subrogation, the surety is entitled to assert, not only the face amount of the claim of the party whom the surety pays, but also all of the payee's collection rights, as though the surety were the payee. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 138; *Pandora Indus., Inc. v. Paramount Commc'ns Inc. (In re Wingspread Corp.)*, 145 B.R. 784, 791 (Bankr. S.D.N.Y. 1992) ("Under the doctrine of subrogation, a subrogee is entitled to assert any priority or special right of the subrogor."), *aff'd*, 992 F.2d 319 (2d Cir. 1993); *Niagara Fire Ins. Co. v. United States*, 76 F. Supp. 850, 855 (S.D.N.Y. 1948) ("[B]y the operation of the doctrine of subrogation, the subrogee becomes the owner of the very rights of the individual who suffered injury to his person or property; they are not similar or analogous but identical.").

because it did not adequately describe how PG&E's plan would treat its workers' compensation obligations or Travelers' rights as surety. JA 30a-33a. Recognizing the Disclosure Statement's inadequacies, the bankruptcy court required PG&E to specify the treatment of workers' compensation claims and Travelers' rights. JA 43a-45a, 48a-49a.

At the hearing on the adequacy of the Disclosure Statement, Travelers explained the filing of its proof of claim, its role as surety, and its rights. JA 35a-51a. Travelers also explained the importance of PG&E's failure to disclose the proposed treatment of the claims held by workers entitled to receive workers' compensation benefits:

> Traditionally, what happens is that the debtor wants to render [its workers' compensation claims] unimpaired [i.e., unaffected by the debtor's bankruptcy case], because if the debtor doesn't render these unimpaired under the plan, [the debtor] may not be able to get self-insured surety coverage, the state may not allow them to get that post-confirmation, and as I note under the debtor's disclosure statement, they intend to go for self-insurance, but like I said at the outset, this is an issue which has to be gotten right, in order for their potential program to work. It also has to be gotten right under 1125, because we need to know what's happening to the claims.

JA 40a-41a. The bankruptcy court agreed, and asked the representative of PG&E's corporate parent, PG&E Corporation, the principal proponent of the Plan (the "Parent"), what it intended to do with the claims. JA 41a ("But let's take a simple answer. What is the fate of pre-petition worker's comp claimants under the post-confirmation regime?"). The Parent replied: "[W]hat we're prepared to do, regardless of what the current state of affairs is, is just to add a statement that makes clear that the claims of the workers themselves will pass through with the reorganized debtor remaining obligated to pay for them." *Id.* Travelers then inquired: "The magic words I'm hoping to hear, perhaps I am hearing them, is that they're rendered unimpaired." JA 42a. The bankruptcy court then stated: "Unimpaired." *Id*. The Parent replied: "Yes."

Id.; see 11 U.S.C. § 1124 (defining the concept of "unimpaired" treatment under a chapter 11 plan as express treatment in the plan that leaves a creditor's non-bankruptcy rights unaffected by the debtor's bankruptcy case); *Bank of Am Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 442 n. 14 (1999) ("Claims are unimpaired if they retain all of their prepetition legal, equitable and contractual rights against the debtor.").

Travelers then inquired about the treatment of its subrogation rights: "What we'd also like to know is whether our subrogation rights are being rendered unimpaired under 509(a). Simply put, that solves the problem." JA 44a. The bankruptcy court asked: "Can we have a position on that?" *Id*. The Parent replied: "Your Honor, I don't believe a subrogation right is a claim against the debtor. It's the right to step into someone else's claim and whatever that treatment is, it is." *Id*. The bankruptcy court stated: "Yeah, that's what I thought too. You don't have a separate claim, you just take over the claim." JA 44a. To this Travelers replied: "As long as nothing in the plan will, or purports to impair Traveler's subrogation rights, I'll settle for that." JA 45a.

Critically, the bankruptcy court then stated: "Well, can we solve that problem, then, by you're [sic] defining this new class to be the claimants, but then provide and/or Travelers to the extent that by subrogation it takes over the claim, words to that effect?" *Id*. The Parent replied: "Certainly." *Id*. PG&E likewise replied: "Certainly." *Id*.

Following this exchange, the parties left the courtroom and negotiated particular language to be inserted into the Disclosure Statement and Plan to implement this agreement. JA 51a. Specifically, the parties agreed that the Plan would provide that the claims of workers to workers' compensation benefits would be placed in their own class under the Plan and rendered unimpaired, and that the Plan would also leave unimpaired any right that Travelers would have to be subrogated to the claims of the workers in the event Travelers were ever called upon to make payment under the Bonds (the "Negotiated Language"). This Negotiated Language appeared in the next versions of the Disclosure

Statement and Plan and provided, with respect to Travelers' subrogation rights, as follows: "Nothing in th[e] Disclosure Statement[s] or Plan[s] shall affect . . . the subrogation rights . . . of any surety of pre-petition or post-petition Workers' Compensation Claims." JA 54a ¶ 4.21, 56a ¶ 11.21, 60a-62a ¶ 4, 64a ¶ 22, 66a ¶ 21.

The Negotiated Language reflected the straightforward resolution of a problem critical to PG&E's ability to reorganize, and also important to the protection of Travelers' rights. In order to preserve its ability to maintain its self-insured status, PG&E provided that it would remain fully obligated to pay its workers' compensation obligations. Similarly, in the event that PG&E were to default in the future on these obligations, and Travelers were to make payment under its Bond, Travelers would be entitled to step into the workers' shoes through its right of subrogation and enforce the workers' rights against PG&E to recover whatever Travelers might pay -- including the workers' right under the Plan to have their claims paid. *In re Wingspread Corp.*, 145 B.R. 784, 791 (Bankr. S.D.N.Y. 1992) ("Under the doctrine of subrogation, a subrogee is entitled to assert any priority or special right of the subrogor."), *aff'd*, 992 F.2d 319 (2d Cir. 1993). Because the Bankruptcy Code does not permit a debtor to avoid a surety's subrogation rights (indeed, section 509(a) of the Code expressly preserves them), PG&E did not give up anything. On the contrary, by providing that it would honor its workers' compensation obligations in full, PG&E not only preserved its ability to retain its self-insured status after it emerged from bankruptcy, it enhanced its ability to obtain workers' compensation bonds from its sureties to qualify for self-insured status.

D. PG&E's Unilateral Modification Of The Negotiated Language And Pursuit Of Litigation Against Travelers

Had PG&E left the Negotiated Language in its Plan and Disclosure Statement as expressly agreed, there would have been no subsequent litigation over Travelers' subrogation rights. However, for reasons that have never been explained, PG&E reneged on its agreement and without warning unilaterally modified the Negotiated Language to state that "[n]othing herein

shall affect . . . the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights [of Travelers]." JA 54a ¶ 4.21, 56a ¶ 11.21, 60a-62a ¶ 4, 64a ¶ 22, 66a ¶ 21.

Moreover, on or about March 18, 2002, PG&E commenced litigation against Travelers by filing an objection to Travelers' proof of claim (the "Objection"). JA 67a. In its Objection, PG&E lumped together all of Travelers' rights and argued that *all* had to be disallowed. JA 69a-80a. In addition, PG&E separately argued that Travelers' reimbursement rights had to be disallowed because they are contingent. JA 69a-75a. PG&E also separately argued that Travelers' subrogation rights had to be "disallowed," did not exist, and "are not valid." JA 69a-80a. Further, PG&E asked the court to disallow the claims that Travelers had filed on behalf of the injured workers under section 501(b) of the Code. JA 76a-79a. If PG&E had been successful in its Objection, all of Travelers' rights against PG&E could have been extinguished or impaired even though Travelers remained liable to third parties under its Bond.

By unilaterally modifying the Negotiated Language in the Plan and by commencing litigation against Travelers with the filing of its Objection, PG&E clearly challenged and sought to eliminate or impair Travelers' reimbursement and subrogation rights. Compelled to defend its rights, Travelers opposed the Objection and objected to the Plan. JA 82a-102a.

E. The Parties' Stipulation

Following extensive negotiations, Travelers and PG&E entered into a stipulation (the "Stipulation") to "fully resolve all objections to the Claims without further litigation." JA 106a. Travelers agreed to the disallowance of its direct reimbursement claim (other than for its attorneys' fees), *expressly subject to* Travelers' right to seek reconsideration and allowance in the event that Travelers is ever obligated to make payment under its Bond. JA 107a; *see* 11 U.S.C. § 502(j) (providing for the reconsideration of a claim that has been disallowed if the claim should be allowed in the future). Thus, in the event that Travelers ever has to make payment under its $100 million Bond, Travelers retains the right to seek recovery

from PG&E under the Indemnity Agreements, notwithstanding the disallowance. Travelers' subrogation rights, including any priority to which Travelers may be subrogated, are also expressly preserved. JA 108a ("To the extent that Travelers is subrogated to the claim of any obligee under any of its Surety Bonds, Travelers shall hold such claim as a general unsecured creditor, provided that, to the extent that the claim in the hands of the obligee is entitled to priority, Travelers shall be entitled to the same priority with respect to such claim, except as provided in section 507(d) of the Bankruptcy Code."). Finally, PG&E remained obligated under its Plan to pay all of its workers' compensation obligations in full.

PG&E's failure to provide adequate disclosure until after litigation; its unilateral decision to alter the Negotiated Language in the Plan and Disclosure Statement; and its needless litigation with Travelers thereafter, caused Travelers to incur significant attorneys' fees in the defense of its rights. If Travelers had not acted to protect its rights and defend the litigation that PG&E commenced, Travelers' rights and claims against PG&E may have been discharged or otherwise eliminated or impaired, even though Travelers remained liable on its Bond. *See, e.g.,* 11 U.S.C. § 1141(d) (discharging all claims except those that are preserved in the confirmed chapter 11 plan of reorganization); FED. R. BANKR. P. 7055 (authorizing bankruptcy court to enter default judgments); *see also Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 459 (2004) (Thomas, J., dissenting) (if State acting as a creditor "does not oppose the debtor's [request to eliminate the State's rights as a creditor], the Bankruptcy Court is authorized to enter a default judgment" in the debtor's favor). Preserving Travelers' contractual right to recover its fees, the Stipulation expressly provides: "Subject to the right of a party in interest to object as provided herein, Travelers may assert its claim for attorneys' fees under the Indemnity Agreements as a general unsecured claim against PG&E." JA 108a-109a. On November 8, 2002, the bankruptcy court approved the Stipulation. JA 110a.

F. Travelers' Amended Proof Of Claim And PG&E's Objection

Pursuant to the Stipulation, Travelers filed its amended proof of claim (the "Amended Claim") on or about January 6, 2003, seeking to recover the attorneys' fees it incurred in protecting its rights during the course of PG&E's chapter 11 case, including fees incurred in pursuing its objection to the Disclosure Statement and those incurred in defending against PG&E's Objection to Travelers' rights and claims. SJA 18-21. PG&E objected to the Amended Claim, contending, *inter alia*, that Travelers could not recover attorneys' fees for bankruptcy-related matters (the "Second Objection"). JA 117a-119a. On or about May 12, 2003, at PG&E's request, Travelers provided PG&E with additional information regarding its fees, including a break-down of the fees into separate categories and an explanation of why PG&E is properly liable for these fees. JA 120a-124a. Travelers also withdrew certain expenses to which PG&E specifically objected. *Id.*

G. The Bankruptcy Court's Ruling

At a hearing held on July 11, 2003, the bankruptcy court sustained PG&E's Second Objection solely on the legal ground that Travelers could not assert a claim for attorneys' fees under applicable Ninth Circuit precedent. Pet. App. 23a-25a. While recognizing that Travelers had the right to protect its interests, *see* Pet. App. 24a-25a, the court nonetheless ruled from the bench that Travelers' claim for attorneys' fees would be disallowed as a matter of law because the fees were incurred in the context of adjudicating bankruptcy-related issues, *id.* In reaching its conclusion, the court relied on the Ninth Circuit's decision in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), and subsequent cases following *Fobian*. *E.g., Renfrow v. Draper*, 232 F.3d 688 (9th Cir. 2000); *Am. Express Travel Related Servs. Co. v. Hashemi (In re Hashemi)*, 104 F.3d 1122 (9th Cir. 1997); *Ford v. Baroff (In re Baroff)*, 105 F.3d 439 (9th Cir. 1997).

H. The District Court's Ruling

On appeal, the district court affirmed on the same ground as the bankruptcy court. Pet. App. 10a-19a. The district court observed that the bankruptcy court did not reach any other issue

regarding Travelers' claim, such as the issue of the reasonableness of Travelers' fees. Pet. App. 9a. The court stated: "This is because the bankruptcy court ultimately found that Travelers' claim for attorneys' fees should be disallowed because 'as a matter of bankruptcy law, they cannot be assessed against the Debtor in any amount.'" *Id*. (quoting bankruptcy court's decision). The district court similarly relied on the Ninth Circuit's *Fobian* rule and its progeny.

I. The Ninth Circuit's Ruling

On further appeal, the Ninth Circuit affirmed. In doing so, it largely incorporated by reference its reasoning in *DeRoche v. Ariz. Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006), *reh'g denied*, No. 04-15258 (9th Cir. Feb. 8, 2006). Pet. App. 2a-3a. Applying *Fobian*, the Ninth Circuit found that a contractual right to attorneys' fees is enforceable only "if state law governs the substantive issues raised in the proceedings." *Id.* Stating that "attorneys' fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law,'" the Ninth Circuit held that Travelers could not recover its attorneys' fees because the dispute arose in connection with PG&E's Disclosure Statement, Plan, and objections to Travelers' claims and rights. *Id.*

SUMMARY OF ARGUMENT

The decision below impermissibly eviscerated Travelers' right to its attorneys' fees in PG&E's bankruptcy case. Travelers' contractual right to its attorneys' fees is valid under applicable state law. Pursuant to section 101(5) of the Bankruptcy Code, Travelers' state-law, contractual right to recover its fees properly constitutes a "claim" for bankruptcy purposes. 11 U.S.C. § 101(5). Pursuant to section 502 of the Code, the bankruptcy court was required to allow Travelers' claim for its fees because none of the express grounds for disallowance apply. 11 U.S.C. § 502(b). The Ninth Circuit's application of its *Fobian* rule in this case impermissibly overrides the text of the Code and is likewise contrary to this Court's precedents recognizing that, in determining whether a creditor has a bankruptcy "claim," a creditor's contractual entitlement to attorneys' fees is, in the first instance, an issue of state law.

The Ninth Circuit's disregard for the Code's text cannot be justified on grounds of pre-emption. There is no express pre-emption here. Nor can the Ninth Circuit's *Fobian* rule be justified on the basis of implied pre-emption. As this Court has held, the Code *utilizes* state law in determining the substance of a creditor's "claim" for bankruptcy purposes. Under the circumstances, there is no reason to conclude that, at the same time, bankruptcy law pre-empts state law for the same purpose.

Nor is there any reason for the creation of a rule of general federal common law requiring the denial of claims for attorneys' fees where the fees arise from the litigation of federal bankruptcy issues. There is no conflict between the Bankruptcy Code and state law on the question whether a contractual right to attorneys' fees properly constitutes a "claim" under the Code. Likewise, there is no other reason to create a common law rule denying claims for fees where, as here, Congress has specified the grounds for the disallowance of claims and has directed that, except for the expressly enumerated grounds, claims "shall" be allowed. 11 U.S.C. § 502(b).

The *Fobian* rule is also contrary to this Court's precedents restricting the ability of federal courts to prescribe the categorical treatment of claims in bankruptcy. The power to prescribe categorical rules of allowance or disallowance is reserved for Congress alone. In addition, the Ninth Circuit's rule conflicts with the historical treatment of claims for attorneys' fees in bankruptcy cases. Following this Court's decision in *Security Mortgage Co. v. Powers (In re Florida Furniture Co.)*, 278 U.S. 149, 154 (1928), courts applying the provisions of the statutory predecessor to the current Bankruptcy Code correctly allowed claims for attorneys' fees incurred in pursuing bankruptcy litigation. There is no indication that Congress intended to alter this historical practice, and the Court should conclude that it endures.

The *Fobian* rule is contrary to the central bankruptcy policy of equality of distribution. By denying Travelers' claim outright, the Ninth Circuit's rule effectively reduced Travelers' recovery to zero, while other creditors will receive payment on their claims -- including those with contractual claims for attorneys' fees incurred

in litigating *state*-law issues. A result that so fundamentally erodes the salient bankruptcy policy of equality of distribution should stem from an express provision of the Code, not a judge-made rule untethered to the statutory text.

The *Fobian* rule is impractical. The rule denies claims for contractual rights to attorneys' fees incurred in litigating federal bankruptcy issues, but not those incurred in litigating state-law issues. In many instances in bankruptcy it is difficult (if not impossible) to sort claims for fees on this basis, imposing an unwarranted burden on the bankruptcy courts.

The *Fobian* rule also leads to absurd results. This is perhaps best illustrated by the Ninth Circuit's application of the rule in *DeRoche v. Ariz. Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006). There the court reached the absurd result that, as a matter of general federal common law, a State is barred from directing that its own agency must pay the attorneys' fees incurred by two of its citizens when the agency unsuccessfully sues them in federal court.

Finally, the *Fobian* rule is inequitable because it eviscerates a common commercial practice -- that of contractually allocating attorneys' fees -- for no valid reason. Because the rule conflicts with the text, history, policy, and structure of the Bankruptcy Code and is contrary to this Court's precedents, the decision below must be reversed.

ARGUMENT

A. Travelers' Claim For Attorneys' Fees Is Allowable Under The Plain Text Of The Bankruptcy Code.

Travelers incurred attorneys' fees in pursuing, protecting, and defending its rights in connection with its $100 million Bond. In particular, Travelers took steps to ensure that, in the event Travelers is ever required to pay workers' compensation benefits under its Bond, it will be able to recover from PG&E the full amount of what it has paid. Travelers did not seek to obtain a present payment from PG&E for amounts that Travelers may have to pay in the future. Rather, Travelers simply sought to protect its ability to recover from PG&E in the event it must ever pay benefits

under the Bond, and to recover its attorneys' fees incurred in protecting its rights and defending against litigation that PG&E commenced to impair those rights.

Contractual indemnity provisions of the kind at issue in this case, including those that allocate liability for attorneys' fees, are valid and enforceable under California law. *Port of Stockton v. Western Bulk Carrier KS*, 371 F.3d 1119, 1121 (9th Cir. 2004) ("Under California law, contractual attorneys' fee provisions are generally enforceable.") (citing CAL. CIV. PROC. CODE § 1021 ("Except as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties . . . ."). Because Travelers holds a pre-petition contractual right to payment of its attorneys' fees that is valid under state law, Travelers holds a "claim" for bankruptcy purposes. 11 U.S.C. § 101(5). Because Travelers holds a "claim" for its fees within the meaning of section 101(5) of the Bankruptcy Code, its claim must be allowed unless some provision of the Code affirmatively disallows it. 11 U.S.C. § 502. No provision of the Code even remotely purports to disallow Travelers' claim, and the courts below were obligated to follow the mandate of the statutory text. 11 U.S.C. § 502(b). Because the Ninth Circuit's *Fobian* rule represents an invalid reworking of Congress's clear statutory regime, it must be rejected.

1. Travelers' contractual right to recover its attorneys' fees from PG&E is a "claim" under the Bankruptcy Code.

This Court has explained repeatedly that, in construing and applying the Bankruptcy Code, a court must begin with the statutory text. *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004) ("The starting point . . . is the existing statutory text."). Moreover, "when the statute's language is plain, the sole function of the courts -- at least where the disposition required by the text is not absurd -- is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotations omitted); *see also Rake v. Wade*, 508 U.S. 464, 471 (1993); *Connecticut Nat'l Bank v. Germain*, 503

U.S. 249, 254 (1992); *United States v. Ron Pair Enters., Inc*., 489 U.S. 235, 241 (1989). Similarly, a court must apply the provisions of the Code as written and refrain from engrafting limitations that do not appear on its face. *E.g.*, *Lamie*, 540 U.S. at 1032; *Hartford Underwriters*, 530 U.S. at 7; *Germain*, 503 U.S. at 254; *United States v. Locke*, 471 U.S. 84, 95 (1985) (courts do not have "carte blanche to redraft statutes in an effort to achieve that which Congress is perceived to have failed to do").

Under the plain terms of the Bankruptcy Code, Travelers' contractual right to its attorneys' fees properly constitutes a "claim" against PG&E. 11 U.S.C. § 101(5). To begin with, section 101(5) of the Code defines the term "claim" to mean any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5). The Court has explained that, as defined in section 101(5), the term "claim" is an expansive concept: "a 'claim' is defined . . . as a 'right to payment,' . . . and a 'right to payment,' we have said, 'is nothing more nor less than an enforceable obligation.'" *Cohen*, 523 U.S. at 218 (quoting *Davenport*, 495 U.S. at 559). The Court has similarly observed that, as used in the Code, the terms "claim" and "debt" are interchangeable -- the term "debt" being defined simply as "liability on a claim." 11 U.S.C. § 101(12); *see Davenport*, 495 U.S. at 558 ("This definition reveals Congress' intent that the meanings of 'debt' and 'claim' be coextensive."). These definitions reflect "Congress' broad rather than restrictive view of the class of obligations that qualify as a 'claim' giving rise to a 'debt.'" *Id.* (citing H.R. Rep. No. 95-595, at 309 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 6266 (describing definition of "claim" as the "broadest possible" and noting that the Bankruptcy Code "contemplates that all legal obligations of the debtor . . . will be able to be dealt with in the bankruptcy case").

The Court has also explained that, in order to determine whether a creditor has a right to payment giving rise to a claim, courts must look in the first instance to substantive non-bankruptcy law:

> Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code. The "basic federal rule" in bankruptcy is that state law governs the substance of claims, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law." "Unless some federal interest requires a different result, there is no reason why [the state] interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."

Raleigh v. Ill. Dep't of Revenue, 530 U.S. 15, 20 (2000) (quoting *Butner v. United States*, 440 U.S. 48, 54-55 (1979); *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161-62 (1946)).

With specific regard to attorneys' fees, the Court long ago concluded that, for purposes of determining whether a creditor holds a claim for its fees arising out of a contract, "[t]he construction of the contract for attorney's fees presents . . . a question of local law." *Security Mortgage Co. v. Powers*, 278 U.S. 149, 154 (1928). Similar to its reasoning in *Raleigh*, the Court acknowledged in *Security Mortgage* that bankruptcy law *might* bar the enforceability of an entitlement to attorneys' fees against the debtor's property in the sense that Congress has the authority to enact such a rule as part of the governing statutory scheme. But the Court also found that bankruptcy law does *not* actually present any such bar: "The character of the obligation to pay attorney's fees presents no obstacle to enforcing it in bankruptcy, either as a provable claim or by way of a lien upon specific property." *Id.*

More recently, in *Cohen*, the Court considered the scope of the term "debt" for purposes of the Code's discharge provisions, and whether the term "debt" encompassed a debtor's state-law liability for treble damages, costs, and attorneys' fees. In that case, a state official determined that the debtor had improperly charged excessive rents to his tenants and ordered him to refund the overage. The debtor then filed for bankruptcy seeking to discharge

the refund obligation. The tenants filed an adversary proceeding in the bankruptcy court, asserting that the debt was non-dischargeable, and that the debtor should be liable to them for treble damages, costs, and attorneys' fees under state law. The Court agreed, concluding that the obligations were all valid "debts" for bankruptcy purposes, 523 U.S. at 223, and, hence, claims. 11 U.S.C. § 101(12).

The holding in *Cohen* demonstrates that a creditor's claim for attorneys' fees properly constitutes an allowable "claim" in a debtor's bankruptcy case. Consistent with this holding, many courts of appeals have long adhered to the rule that a creditor's claim for attorneys' fees constitutes a bankruptcy claim if valid under state law. *E.g.*, *Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998); *Davidson v. Davidson (In re Davidson)*, 947 F.2d 1294, 1297-98 (5th Cir. 1991); *Transouth Fin. Corp. of Fla. v. Johnson*, 931 F.2d 1505, 1507 (11th Cir. 1991); *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 227 (5th Cir. 1991) ("creditors are entitled to recover attorney's fees in bankruptcy claims if they have a contractual right to them valid under state law"); *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985); *Worthen Bank & Trust, N.A. v. Morris*, 602 F.2d 826, 828-29 (8th Cir. 1979).

Considering the specifics of Travelers' contractual right to recover its attorneys' fees in this case in conjunction with the Code's definition of the term "claim," Travelers' entitlement to its fees is plainly a "right to payment" because it is an obligation that is enforceable outside the bankruptcy context under California law. *Cohen*, 523 U.S. at 218. Travelers' right is "unliquidated" because the precise amount has not yet been ascertained. Its right was "contingent" as of the Petition Date in the sense that Travelers had not yet incurred its fees, but is now "fixed" to the extent that Travelers has actually incurred its fees. Travelers' right is also fixed in the sense that its right has existed as an affirmative obligation under the parties' pre-petition Indemnity Agreements since the execution of these contracts. *Stillwater Nat'l Bank & Trust Co. v. Kirtley (In re Solomon)*, 299 B.R. 626, 639 n.55 (B.A.P. 10th Cir. 2003) ("[T]he Debtors unconditionally

guaranteed the . . . debt and there was no evidence that the Bank would forego collection or enforcement from Debtors. In short, the Debtor's liability under the guaranty was not contingent.").

Travelers' right is "matured" because PG&E's obligation to pay the fees has come due, and is "disputed" because PG&E disputes Travelers' entitlement. *In re Moffat*, 107 B.R. 255, 261 (Bankr. C.D. Cal. 1989) (an obligation "matures" when it "becomes due"), *aff'd*, 119 B.R. 201 (B.A.P. 9th Cir. 1990), *aff'd*, 959 F.2d 740 (9th Cir. 1992). Travelers' right is "legal" because it arises out of its contracts, and "unsecured" because Travelers has not taken a lien on any collateral to secure payment of the fees. In sum, Travelers' right to payment of its attorneys' fees is squarely a "claim" for bankruptcy purposes because *each* of the characteristics of its claim fall within the statutory definition.

This Court has made clear that the fact that a contractual obligation to pay attorneys' fees is "contingent" as of the date the debtor commences its bankruptcy case (in the sense that, although the debtor is obligated under a pre-petition contract to pay them, the creditor has not yet incurred the fees) does not remove the obligation from the definition of the term "claim." For example, in *Security Mortgage*, the Court determined that the fact that the creditor's claim for attorneys' fees was "contingent" at the time the debtor commenced its bankruptcy case (meaning that the creditor had a contractual right to collect its attorneys' fees that existed before the debtor filed for bankruptcy, but the creditor had not yet incurred the fees at the time the debtor commenced its case) was no obstacle to the allowance of the claim for fees incurred subsequent to the debtor's bankruptcy filing. 278 U.S. at 155-56.

Following *Security Mortgage*, other courts have also concluded that a creditor may recover its fees where the fees are incurred after the debtor files for bankruptcy, but the creditor's right to the fees arises under a pre-petition contract -- including fees incurred in litigating federal bankruptcy issues. For example, in *In re Martin*, 761 F.2d 1163 (6th Cir. 1985), the debtor executed a loan agreement granting the creditor the right to recover attorneys' fees incurred in collecting the loan. After the debtor filed for bankruptcy relief, the creditor objected to the debtor's

discharge (an issue of bankruptcy law) and sought attorneys' fees in connection with collecting its loan in the bankruptcy court. Following *Security Mortgage*, the Sixth Circuit concluded that the creditor held a valid claim for its fees. *Id*. at 1168.

Similarly, in *Three Sisters Partners, LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999), the debtor executed a lease agreement that obligated the debtor to pay the lessor's attorneys' fees in connection with the lessor's pursuit of its rights. After the debtor filed for bankruptcy, the lessor incurred attorneys' fees in connection with its efforts to recover its property and protect its interests under applicable bankruptcy law. Specifically, the lessor incurred fees in moving for relief under various provisions of the Bankruptcy Code and actively participating in the case. After the debtor "assumed" the lease under section 365 of the Code (i.e., agreed to be bound by its terms), the lessor sought recovery of its fees. The bankruptcy court denied recovery, determining that the lessor could not recover fees for taking actions to protect its interests in the bankruptcy court or litigating bankruptcy issues. The Fourth Circuit reversed, holding that "the bankruptcy court erred to the extent that it applied a bright-line test precluding the award of fees for actions primarily involving issues of bankruptcy law." *Id*. at 852.

As these cases well illustrate, Travelers' state-law, contractual right to recover its attorneys' fees from PG&E constitutes a "claim" for bankruptcy purposes within the plain meaning of section 101(5). In turn, because no provision of the Bankruptcy Code *disallows* Travelers' claim, the courts below erred in refusing to allow it.

2. Travelers' claim must be allowed under section 502 of the Bankruptcy Code.

Pursuant to section 502(a) of the Bankruptcy Code, "[a] claim . . . is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a). PG&E objected to Travelers' claim for its fees. Pursuant to section 502(b), "if [an] objection to a claim is made, the court, after notice and a hearing, *shall* determine the amount of such claim in lawful currency of the United States . . . and *shall*

allow such claim in such amount, except to the extent that [one of several enumerated statutory grounds for disallowance of a claim is present]." 11 U.S.C. § 102(b) (emphasis supplied).

It is clear that none of the express statutory grounds for disallowance set forth in section 502(b) direct disallowance of a claim for attorneys' fees because the fees were incurred in adjudicating bankruptcy issues. On the contrary, as the Court explained long ago in *Security Mortgage*, Congress has elected *not* to prohibit the recovery in bankruptcy of an unsecured claim for attorneys' fees that is valid under state law. 278 U.S. at 149. Indeed, the only statutory restriction on claims for attorneys' fees appearing in section 502 is the provision of section 502(a)(4) that limits a pre-petition claim "for services of an . . . attorney of the debtor" to "the reasonable value of such services." 11 U.S.C. § 502(a)(4).

As a general rule, when Congress intends to create an exception to the express provisions of the Bankruptcy Code, it does so expressly. *See F.C.C. v. NextWave Personal Commc'ns, Inc*., 537 U.S. 293, 302 (2003) ("where Congress has intended to provide . . . exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly"); *Ohio v. Kovacs*, 469 U.S. 274, 279 (1985). If Congress had intended to create an exception to the allowance of claims for attorneys' fees for those arising from the litigation of bankruptcy issues, it could easily have done so. Conversely, that Congress did not create such an exception demonstrates only that Congress intended no such exception to exist, particularly where Congress created express exceptions for certain kinds of attorneys' fees -- those of the debtor's attorney under section 502(a)(4). *NextWave*, 537 U.S. at 302; *Toibb v. Radloff*, 501 U.S. 157, 161 (1991) (refusing to infer exception to section 109 of the Bankruptcy Code, stating, "Congress knew how to restrict recourse to the avenues of bankruptcy relief"); *Kovacs*, 469 U.S. at 279.

Because none of the enumerated statutory exceptions to allowance apply, the plain language of section 502(b) -- which uses the mandatory term "shall" -- requires the allowance of Travelers' claim for its fees. *Miller v. French*, 530 U.S. 327, 337-

38 (2000) (stating that the term "shall" should not be construed as permissive because doing so would undercut the mandatory command of the statute); *Anderson v. Yungkau*, 329 U.S. 482, 485 (1947) (construing the terms "may" and "shall" in their "usual sense -- the one act being permissive, the other mandatory"). The disposition required by the text is neither absurd nor demonstrably contrary to Congress's purpose in enacting the statute, and the lower courts in this case were not at liberty to disallow Travelers' claim in a manner at odds with the governing statutory scheme.

B. The *Fobian* Rule Cannot Be Justified On Grounds Of Pre-Emption Or As A Legitimate Invention Of Federal Common Law.

The *Fobian* rule categorically denies the validity of any contractual allocation of attorneys' fees arising from the litigation of bankruptcy issues, absent express authorization by federal law. Although the bases of the *Fobian* rule are obscure, it is clear that the rule is untethered to any provision of the Bankruptcy Code and exists purely as a matter of general federal common law.

In *Fobian*, the debtors (farmers) defaulted on their mortgage debt to a secured creditor and filed for bankruptcy relief. As part of the bankruptcy proceeding, the creditor sought to protect and defend its rights under sections 506 and 1225 of the Bankruptcy Code (governing the treatment of the creditor's secured claim in the debtors' chapter 12 case). The creditor incurred attorneys' fees pursuing its rights under these provisions and claimed that it was entitled to its fees under the terms of its pre-petition loan agreement. Observing that the proper application of sections 506 and 1225 are matters of federal law, the Ninth Circuit concluded that any right to attorneys' fees incurred in connection with litigating the proper application of these provisions must also be a matter of federal law. The court stated: "[W]here the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorneys' fees will not be awarded absent bad faith or harassment by the losing party." *Fobian*, 951 F.2d at 1153.

In support of its decision, the Ninth Circuit cited three cases: *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738, 741-42 (9th Cir.

1985); *Collingwood Grain, Inc. v. Coast Trading Co. (In re Coast Trading Co.)*, 744 F.2d 686, 693 (9th Cir. 1984); and *Grove v. Fulwiler (In re Fulwiler)*, 624 F.2d 908, 910 (9th Cir. 1980). The Ninth Circuit appears to have derived its *Fobian* rule from dicta in *Johnson*. *See* 756 F.2d at 741 (stating that "because federal [bankruptcy] law governs the disposition of this [bankruptcy question], it should also govern the disposition of the attorney's fee issue in this case" and concluding that, because no federal statute authorized the recovery of attorneys' fees, the fees were not recoverable). In adopting its rule, the court did not examine in any depth the text, structure, history, or policies of the Bankruptcy Code. Nor did it cite this Court's precedents regarding whether a right to attorneys' fees may constitute a claim for bankruptcy purposes. Nor did the court perform any apparent pre-emption analysis. Instead, the court simply announced its standard as a matter of general federal common law -- that contractual rights to attorneys' fees are invalid if the fees arise from the litigation of federal issues unless federal law authorizes the contractual arrangement. In the process, the court essentially federalized the law of contractual allocations of attorneys' fees where litigation over bankruptcy issues is involved.

Wholly apart from the fact that the Ninth Circuit's *Fobian* rule is contrary to the text and structure of the Bankruptcy Code, and likewise this Court's precedents for determining whether a right to attorneys' fees properly constitutes a claim for bankruptcy purposes, the rule is also contrary to this Court's pre-emption standards, as well as those governing the creation of federal common law. Tested under these standards, the Ninth Circuit's rule also fails.

1. There are no grounds for pre-emption in this case.

The Supremacy Clause of the Constitution provides that the laws of the United States "shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2. As far back as *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), it has been settled that state laws in conflict with federal law are without effect. *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992)

(citing *M'Culloch*). At the same time, any pre-emption analysis under the Supremacy Clause "start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . [a] Federal Act unless that [is] the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp*., 331 U.S. 218, 230 (1947); *see Cipollone*, 505 U.S. at 516 (citing *Rice*). The Court has reiterated time and again that "[t]he purpose of Congress is the ultimate touchstone of pre-emption analysis." *Cipollone*, 505 U.S. at 516 (internal quotations omitted) (citing *Malone v. White Motor Corp*., 435 U.S. 497, 504 (1978)); *see also Retail Clerks Int'l Ass'n v. Schermerhorn*, 375 U.S. 96, 103 (1963).

Congressional intent to pre-empt may be found in the express language of the federal statute in question, or may be implied from the structure and purpose of the statutory scheme. *Cipollone*, 505 U.S. at 516 (citing *Jones v. Rath Packing Co*., 430 U.S. 519, 525 (1977)); *see Almendarez-Torres v. United States*, 523 U.S. 224, 228 (1998) (in determining congressional purpose "we look to the statute's language, structure, subject matter, context, and history -- factors that typically help courts determine a statute's objectives and thereby illuminate its text"); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 486 (1996) ("Congress' intent, of course, primarily is discerned from the language of the pre-emption statute and the 'statutory framework' surrounding it. Also relevant, however, is the 'structure and purpose of the statute as a whole.") (internal citations omitted). On the question of express pre-emption, the Court has stated: "When Congress has considered the issue of pre-emption and has included in the enacted legislation a provision explicitly addressing that issue, and when that provision provides a 'reliable indicium of congressional intent with respect to state authority,' 'there is no need to infer congressional intent to pre-empt state laws from the substantive provisions' of the legislation." *Cipollone*, 505 U.S. at 517 (citing *California Fed. Savings & Loan*

Ass'n v. Guerra, 479 U.S. 272, 282 (1987), and *Malone*, 435 U.S. at 505).[7]

Alternatively, where there is no "express congressional command," the Court has found implicitly that "state law is pre-empted if that law actually conflicts with federal law, or if federal law so thoroughly occupies a legislative field as to make reasonable the inference that Congress left no room for the States to supplement it." *Cipollone*, 505 U.S. at 516 (internal quotations omitted) (citing *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 204 (1983), and *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 153 (1982)); *see also English v. General Elec. Co*., 496 U.S. 72, 79 (1990) (discussing implied pre-emption); *Butner*, 440 U.S. at 54 n.9 & 55 ("[S]tate laws are . . . suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress . . . . Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."); *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) (state laws are suspended by bankruptcy only to the extent of an actual conflict with bankruptcy policy).

In determining whether express or implied pre-emption is present, there is a presumption that Congress does not undertake lightly to pre-empt state law, particularly in areas that have traditionally been subject to state regulation:

> [B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action. In all pre-

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[7] Where express pre-emption is present, a conflict analysis may still be necessary to the extent a state statute is not encompassed within the scope of express pre-emption, but conflicts with a federal statute. *Freightliner Corp. v. Myrick*, 514 U.S. 280, 288-89 (1995) ("Our subsequent decisions have not read *Cipollone* to obviate the need for analysis of an individual statute's pre-emptive effects.").

> emption cases, and particularly in those in which Congress has 'legislated . . . in a field which the States have traditionally occupied,' we 'start with the assumption that the historic police powers of the States were not to be superceded by the Federal Act unless that was the clear and manifest purpose of Congress.'

Medtronic, 518 U.S. at 485 (internal citation omitted).

Moreover, in cases between private parties involving contractual rights governed generally by state law, the relevant question is whether the federal statute pre-empts the particular contractual rights at issue. For example the Court held in *Cipollone* that the plaintiff's state law contract claim for breach of express warranty was not pre-empted by the Public Health Smoking Act, which pre-empted generally any requirement "imposed under State law" concerning the regulation of tobacco products. 505 U.S. at 515, 526; *see Am. Airlines, Inc. v. Wolens*, 513 U.S. 219 (1995) (holding that Airline Deregulation Act pre-empted claims based on Illinois Consumer Fraud and Deceptive Business Practices Act, but did not pre-empt state law breach of contract action alleging that airline had violated agreement which it had entered into with its passengers). In *Cipollone*, the Court observed that the contractual obligations of the parties were not requirements "imposed under State law," but instead existed by virtue of the parties' private contractual relationship. *Id.* at 526 n.24. In this case, nothing in the Bankruptcy Code even remotely purports to expressly or impliedly pre-empt state law on the question of the general validity of a party's contractual obligation to pay attorneys' fees.

The Bankruptcy Code provides a framework under which (1) creditors may obtain satisfaction (at least in part) of their pre-petition rights to payment to the extent of funds available to satisfy them; (2) insolvent debtors may obtain the discharge of their debts; and (3) insolvent but viable businesses may be rehabilitated. *E.g.*, *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) (observing the bankruptcy reorganization policy of permitting the "successful rehabilitation of debtors"); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("one of the prime purposes of bankruptcy law has been to

bring about a ratable distribution among creditors of a bankrupt's assets"); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 (1935) ("The discharge of the debtor has come to be an object of no less concern than the distribution of his property."). Within that framework, the Code actually *incorporates* state law in a number of ways.

For example, upon the commencement of a bankruptcy case, the Bankruptcy Code creates a bankruptcy estate consisting of all of the debtor's interests in property. 11 U.S.C. § 541.[8] The Code itself, however, neither creates nor defines the debtor's property rights that comprise the estate. Instead, state law determines the substance of the debtor's property rights. *California. v. Farmers Mkts., Inc. (In re Farmers Mkts., Inc.)*, 792 F.2d 1400, 1402 (9th Cir. 1986) (noting that non-bankruptcy law determines the scope of a debtor's interest in a given asset). Thereafter, the Code prescribes the disposition of the estate in accordance with its own provisions. *E.g.*, 11 U.S.C. §§ 701, 702 (providing for the appointment or election of chapter 7 bankruptcy trustee), 704 (specifying the duties of the trustee, including liquidating property of the estate), 725, 726 (specifying the disposition of the property of the estate). Clearly, the Bankruptcy Code does not expressly or impliedly pre-empt state law on the critical issue of what, in the first instance, constitutes the debtor's property.

Just as the debtor's property rights are determined by state law for purposes of establishing the content of the estate, the existence and amount of the creditors' claims are also determined by state law. Bankruptcy law does not supply its own independent regime

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[8] Section 541 provides that a debtor's estate succeeds to all of the debtor's pre-petition assets, including claims and causes of action. 11 U.S.C. § 541(a)(1); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.9 (1983) ("'The scope of this paragraph [§541(a)(1)] is broad. It includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act § 70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act.'") (citing H.R. Rep. No. 95-595, at 367 (1977); S. Rep. No. 95-989, at 82 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5868, 6323).

of property rights for purposes of establishing a creditor's claim. Rather, the Code simply incorporates each creditor's state law rights to payment within the definition of a "claim" and prescribes the disposition of the creditor's claim. *E.g.*, 11 U.S.C. §§ 101(5), 502(b) (providing for the allowance of claims generally, and the disallowance of certain claims), 727 (providing for the discharge of debts in chapter 7 cases).

Given that the Bankruptcy Code actually *utilizes* state law to determine whether a creditor has a right to payment and to supply the substance of a creditor's claim, there is no basis to conclude that the Code expressly or impliedly pre-empts state law in determining whether, in the first instance, a creditor has a right to payment. Yet, the Ninth Circuit's *Fobian* rule does just that: It treats the existence of a right to payment involving attorneys' fees as a substantive issue of federal law if the fees arise in connection with litigating bankruptcy issues. But there is no warrant for such pre-emption under the Code and, accordingly, the *Fobian* rule fails under this Court's pre-emption precedents.

2. There is no basis for the creation of a common law rule.

Under the so-called "American rule," it is axiomatic that, in general, a party to litigation in the United States bears its own legal fees. However, the Court has stated repeatedly that "[t]he rule here has long been that attorney's fees are not ordinarily recoverable *in the absence of a statute or enforceable contract providing therefor*." *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 717 (1967) (emphasis supplied); s*ee also Aleyska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 247 (1975). And like other contract issues, the law governing the enforceability of a contractual provision allocating attorneys' fees is generally applicable state law.

Although this Court has found that contracts governed by state law provide a valid basis for claiming attorneys' fees in bankruptcy, the rule followed by the Ninth Circuit in this case is that "no [attorney's] fees are available under state law for litigation of substantive federal bankruptcy issues in bankruptcy court." *DeRoche*, 434 F.3d at 1192. On its own initiative, the Ninth Circuit has supplanted the state law of contracts that this Court has

long respected, and has replaced it with a new federal common law rule. *Atherton v. FDIC*, 519 U.S. 213, 218 (1997) ("'[F]ederal common law' in the strictest sense, [is] a rule of decision that amounts, not to simply an interpretation of a federal statute or a properly promulgated administrative rule, but, rather, to the judicial 'creation' of a special federal rule of decision.") (citing *Tex. Indus., Inc. v. Radcliff Mats., Inc*., 451 U.S. 630, 640-43 (1981)).

The creation of new federal common law rules of decision is justified in only the rarest of circumstances:

> The Court has said that "cases in which judicial creation of a special federal rule would be justified . . . are . . . 'few and restricted.'" *O'Melveny & Meyers v. FDIC*, 512 U.S. 79, 87, (1994) (quoting *Wheeldin v. Wheeler*, 373 U.S. 647, 651, 83 (1963)). "Whether latent federal power should be exercised to displace state law is primarily a decision for Congress," not the federal courts. *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966). Nor does the existence of related federal statutes automatically show that Congress intended courts to create federal common-law rules, for "'Congress acts . . . against the background of the total *corpus juris* of the states . . . .'" *Id*. at 68 (quoting H. Hart & H. Wechsler, The Federal Courts and the Federal System 435 (1953)). Thus, normally, when courts decide to fashion rules of federal common law, "the guiding principle is that a significant conflict between some federal policy or interest and the use of state law . . . must first be specifically shown." 384 U.S., at 68. Indeed, such a "conflict" is normally a "precondition." *O'Melveny*, *supra*, at 87. *See also United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979); *Kamen v. Kemper Fin. Services, Inc.*, 500 U.S. 90, 98 (1991).

Atherton, 519 U.S. at 218-19.

In *Atherton*, the Court noted that "[n]o one doubts the power of Congress to legislate rules for deciding cases," but recognized that none of the relevant statutes enacted by Congress actually provided

a rule of decision, which, in that case, involved the applicable standard of care by which a party's conduct would be judged. *Id*. at 219. The Court explained that, in the absence of a federal standard, "we must decide whether the application of state-law standards of care . . . would conflict with, and thereby significantly threaten, a federal policy or interest." Finding no such conflict, the Court allowed the state-law standard to be applied. *Id*.

There is no basis for the Ninth Circuit's common law *Fobian* rule. In considering the adoption of federal common law rules, courts are admonished to remember that "Congress acts . . . against the background of the total *corpus juris* of the states." *Atherton*, 519 U.S. at 218. Courts must also determine that there exists a "significant conflict between some federal policy or interest and the use of state law" because such a showing is a "precondition" to the creation of a federal common law rule of decision. *Id*. at 218-19. No such showing is possible here.

As demonstrated above, the Bankruptcy Code affirmatively employs state law to define the substance of a creditor's "claim." Far from demonstrating any conflict with this use of state law, the Code's text and structure reveal exactly the opposite -- that the successful operation of the Code's claims resolution procedures depends in the first instance on state law to supply the substance of each creditor's claim. There is thus no basis for concluding that federal bankruptcy law supports the creation of a common law rule governing contractual allocations of attorneys' fees.

Moreover, such a common law rule only interferes needlessly with market practices and expectations. Every day, parties enter into contracts allocating the costs of litigation. These contracts include insurance policies, surety bonds, settlements, and indemnity agreements. Just as there is no general federal common law of contract, there is also no general federal common law of contractual loss-allocation applicable in or out of bankruptcy. Rather, in the absence of specific federal pre-emption, contracts allocating the costs of litigation (including attorneys' fees) are governed by state law irrespective of whether the losses arise from a controversy involving issues of state or federal law. *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 83, 87-88 (1994) (reiterating that

"[t]here is no federal general common law" and that there must be a "significant conflict between some federal policy or interest and the use of state law . . . as a precondition for recognition of a federal rule of decision" in order to avoid becoming "awash in 'federal common-law' rules") (citations omitted).

For example, it is routine for parties to enter into contractual settlement agreements allocating the costs of a particular lawsuit. Except to the extent specifically pre-empted by federal law, the enforceability of such an agreement (like any other contract) is obviously a question of state law, even though the settled controversy involves federal issues. Likewise, because the definition of a "claim" in bankruptcy includes virtually every kind of contractual obligation, a party's obligation under a settlement agreement involving litigation over federal issues may form the proper basis for a claim in bankruptcy.

Surety bonds and policies of insurance allocating particular liabilities also are routine. Except to the extent specifically pre-empted by federal law, the enforceability of these contracts is also purely a question of state law, even though the contract covers liabilities incurred in litigating federal issues or with federal entities. For example, a claim under a fidelity bond by a federal agency is properly governed by applicable state law. *FDIC v. Nat'l Union Fire Ins. Co*., 205 F.3d 66, 70 (2d Cir. 2000) ("Although the FDIC is a party to this suit, recovery under the bond in this case is determined under principles of New York law.").

Indemnity agreements allocating losses are also commonplace. Except to the extent specifically pre-empted by federal law, the enforceability of a contract of indemnity allocating the costs of litigation is also purely a question of state law, even though the matters that are the subject of the indemnity may involve federal issues. For example, an attorneys' fee provision is enforceable under state law even though the subject matter of the litigation giving rise to the particular fees is one in admiralty. *Port of Stockton v. Western Bulk Carrier KS*, 371 F.3d 1119, 1121 (9th Cir. 2004) (stating in admiralty case that the enforceability of an attorneys' fee provision is a matter of state law).

In other areas, courts routinely honor contractual rights to attorneys' fees without federal statutory authorization in cases involving an underlying adjudication of federal issues. *E.g*., *Coastal Fuels Mktg., Inc. v. Fla. Express Shipping Co.*, 207 F.3d 1247 (11th Cir. 2000) (maritime law); *Sea-Land Serv., Inc. v. Murrey & Sons Co.*, 824 F.2d 740 (9th Cir. 1987) (same); *United States ex rel. C.J.C., Inc. v. Western States Mech. Contractors, Inc*., 834 F.2d 1533 (10th Cir. 1987) (Miller Act); *United States ex rel. Noyes v. Kimberly Constr., Inc*., 43 Fed. Appx. 283 (10th Cir. 2002) (same); *Franklin Fin. v. Resolution Trust Corp*., 53 F.3d 268 (9th Cir. 1995) (Financial Institutions Reform, Recovery and Enforcement Act); *Resolution Trust Corp. v. Miller*, 67 F.3d 308 (9th Cir. 1995) (unpublished opinion) (Federal Deposit Insurance Corporation Statute).

For example, in *Coastal Fuels*, the Eleventh Circuit reviewed an admiralty case involving damages to a chartered vessel in which the lower court awarded attorneys' fees to the principal prevailing vessel owner. 207 F.3d 1247. In addressing the vessel owner's entitlement to attorneys' fees under federal maritime law, the Eleventh Circuit observed the general rule in admiralty that "[a] party is not entitled to attorney's fees . . . unless fees are statutorily or contractually authorized," but concluded that such fees are authorized because of the specific provision within the bareboat charter agreement allowing for the recovery of attorneys' fees as damages for breach of the charter. *Id*. at 1250-51. Recognizing the same limitation to the recovery of attorneys' fees in federal court, the Ninth Circuit, in *Sea-Land Service*, affirmed a district court's award of attorneys' fees to a prevailing carrier under the Shipping Act because the bill of lading constituted a valid contract between the parties and expressly provided that the shipper was liable for attorneys' fees incurred in the collection of freight changes thereunder. 824 F.2d at 744-45.

Subcontracts allocating liability for attorneys' fees in the context of the Miller Act have been repeatedly honored, despite the fact that the federal statute itself does not provide for such fees. In *Noyes*, the Tenth Circuit found that the district court abused its discretion in halving attorneys fees to a supplier pursuant to a sales

contract that provided for payment of attorneys' fees by the buyer/subcontractor in the event of default. 43 Fed. Appx. 283. In remanding with instructions for the district court to state its reasoning for reducing the fees claimed, the Tenth Circuit explained that the provision of fees in a commercial agreement is "fundamentally different" from statutes and held that "where a contract, as opposed to a statute, provides for attorney's fees, the district court should . . . award fees consistent with their contractual purpose: to give the parties the benefit of their bargain." *Id*. at 288 (citing *United States ex rel. C.J.C., Inc. v. Western States Mech. Contractors, Inc*., 834 F.2d 1533, 1548 (10th Cir. 1987)). Demonstrated in reverse, the Tenth Circuit held in *C.J.C.* that a subcontractor was not entitled to attorneys' fees in its Miller Act breach of contract action against a contractor because there was no provision in the subcontract providing for payment of fees. 834 F.2d at 1543 ("The Act does not provide attorneys' fees for the prevailing party. Absent a provision in the contract . . ., a Miller Act plaintiff may only recover under one of the federally recognized exceptions to the general principle that each party should bear the costs of its own legal representation.") (internal citation omitted). The Tenth Circuit made clear, however, that "[w]hen the agreement between the contractor and the subcontractor provides for attorneys' fees, the subcontractor may recover from the contractor and its Miller Act surety consistent with the terms of that agreement." *Id*. at 1548.

The Financial Institutions Reform, Recovery and Enforcement Act, a federal receivership and conservator scheme, also recognizes contracts providing for attorneys' fees. In *Franklin Financial*, a receiver was appointed to manage or dispose of the assets of a federally chartered savings and loan association. 53 F.3d 268. The receiver decided to repudiate a lease that it determined to be burdensome. *Id*. at 269-70. Subsequent litigation arose between the receiver and the association over the repudiation. The receiver sought recovery of attorneys' fees under the terms of the repudiated lease. The Ninth Circuit recognized that the attorneys' fees provisions in the contract were enforceable under Oregon law and remanded the case to the lower court to

determine the amount of attorneys' fees to be awarded to the receiver. *Id*. at 273. *See* OR. REV. STAT. § 20.096 (2004). ("In any action or suit in which a claim is made based on contract, where such contract specifically provides that attorney fees and costs incurred to enforce the provisions of the contract shall be awarded to one of the parties, the party that prevails on the claim, whether that party is the party specified in the contract or not, shall be entitled to reasonable attorney fees in addition to costs and disbursements."); *see also Resolution Trust Corp. v. Miller*, 67 F.3d 308 (9th Cir. 1995) (unpublished) (honoring attorneys' fees provision of promissory note in litigation involving the Federal Deposit Insurance Corporation Statute, 12 U.S.C. § 1823(e)).

As these and similar decisions demonstrate, a contractual right to attorneys' fees is not rendered invalid simply because the fees are incurred in a federal proceeding involving questions of federal law. Where, as here, no provision of the Bankruptcy Code disallows Travelers' valid contractual, state-law claim for attorneys' fees, no other rule of federal law requires that Travelers' state law rights be abrogated. Accordingly, the decision below must be reversed.

C. The *Fobian* Rule Conflicts With This Court's Precedents Restricting The Ability Of Federal Courts To Prescribe The Categorical Treatment Of Claims In Bankruptcy.

The *Fobian* rule is also wrong because it conflicts irreconcilably with the Court's precedents restricting the ability of federal courts to categorically establish how claims are to be treated under the Bankruptcy Code. *United States v. Noland*, 517 U.S. 535 (1996); *United States v. Reorganized CF&I Fabricators of Utah, Inc*., 518 U.S. 213 (1996). In *Noland*, the Sixth Circuit approved the categorical subordination of certain tax penalty claims. The court reasoned that, under principles of equitable subordination, the penalty claim at issue should not be paid on par with other unsecured claims, even though the United States had done nothing inequitable in pursing the relevant penalties (inequitable conduct being a traditional requirement for equitable subordination). This Court reversed, concluding that federal courts do not have the authority to prescribe the categorical treatment of

claims "at the same level at which Congress operated when it made its characteristically general judgment to establish the hierarchy of claims in the first place." *Noland*, 517 U.S. at 540; *see also CF&I*, 518 U.S. at 228-29.

Applying the Court's reasoning in *Noland* and *CF&I* to the treatment of claims for attorneys' fees, the *Fobian* rule is similarly "inappropriately categorical." *Noland*, 517 U.S. at 543. In essence, *Fobian* and its progeny establish that *all* claims for attorneys' fees arising from indemnity agreements must be categorically disallowed under the Bankruptcy Code if the fees relate to the litigation of bankruptcy issues. Policy judgments of this kind, however, are properly reserved for Congress, not the courts. Because Congress has not prescribed such a categorical exclusion in the Bankruptcy Code, the *Fobian* analysis is unsound. *See also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) (proscribing "policy determinations that the Bankruptcy Code gives [the court] no authority to make").

D. The *Fobian* Rule Conflicts With The Historical Treatment Of Claims For Attorneys' Fees In Bankruptcy.

This Court has stated that, "[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (internal quotation marks and citation omitted). Similarly, the Court "'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" *Cohen*, 523 U.S. at 221 (quoting *Davenport*, 495 U.S. at 563); *see CF&I*, 518 U.S. at 221 (1996); *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 500-02 (1986); *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 218 (1936) ("To fix the meaning of these provisions [of the Bankruptcy Act] there is need to keep in view the background of their history.").

Following this Court's decision in *Security Mortgage Co. v. Powers*, 278 U.S. 149 (1928), courts applying the former Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1979) (the predecessor to the current Bankruptcy Code) allowed claims for attorneys' fees if the creditor holding the claim was entitled to the fees under state law. There is no indication that Congress intended

to abrogate this practice in enacting the provisions of the Code. Accordingly, the Court should conclude that it endures.

The former Bankruptcy Act did not define the term "claim" in its the general definitional provisions. The Act did, however, define the term "debt" as "any debt, demand, or claim provable in bankruptcy." 11 U.S.C. § 1(14) (repealed 1979). In turn, section 63 of the Act provided that "[d]ebts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, . . . absolutely owing at the time of the filing of the petition . . ., whether then payable or not . . . [and] (8) contingent debts and contingent contractual liabilities." 11 U.S.C. § 103 (repealed 1979).[9] Section 57 of the Act provided additional requirements of proof in order for a claim to be allowed. 11 U.S.C. § 93 (repealed 1979); *see* 3 COLLIER ON BANKRUPTCY ¶ 57, at 101-102 (14th ed. 1977) (discussing section 57 and former Bankruptcy Rule 301 implementing section 57); 3A COLLIER ON BANKRUPTCY ¶ 63.15[3], at 1775-78 (14th ed. 1975) (discussing difference between the concepts of "provablility" and "allowability").

Following this Court's decision in *Security Mortgage*, courts routinely allowed claims for attorneys' fees if the creditor was entitled to the fees under applicable state law. *See Mills v. East Side Investors (In re East Side Investors)*, 702 F.2d 214, 215 (11th Cir. 1983) ("The filing of a petition for reorganization under Chapter XII of the Bankruptcy Act does not diminish the debtor's obligation for attorney fees if vested when the petition is filed."); *James Talcott, Inc. v. Wharton (In re Continental Vending Mach.*

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[9] As originally enacted, section 63 of the Act did not provide for the provability and allowance of claims that were contingent as of the petition date. 3A COLLIER ON BANKRUPTCY ¶ 63.15[3] at 1853 (14th ed. 1975). In 1938, however, the Bankruptcy Act was amended to include subsection (8), which allowed claims that were contingent to be "proved." 11 U.S.C. § 103(8); *see* 3A COLLIER ON BANKRUPTCY ¶ 63.15[3] at 1852-53 (14th ed. 1975) (discussing 1938 amendment and inclusion of subsection (8)).

Corp.), 543 F.2d 986, 992-93 (2d Cir. 1976) (allowing recovery of fees pursuant to state law); *In re Ferro Contracting Co.*, 380 F.2d 116, 120 (3d Cir. 1967) (allowing recovery on claim for contractual allocation of attorneys' fees based on state law); *Hartman v. Utley*, 335 F.2d 558, 559 (9th Cir. 1964) (following *Security Mortgage* and stating that "[t]here is nothing in the character of an agreement to pay attorneys' fees that renders it suspect in bankruptcy. If the agreement is valid under local law, a claim based upon it is provable in bankruptcy"); *Mesard v. Ullmann (In re Am. Motor Prods.)*, 98 F.2d 774, 775 (2d Cir. 1938) (applying *Security Mortgage* analysis in allowing fees and stating that "[t]here are no general equitable principles under which, in the absence of fraud or usury, a court may substitute its own ideas of what would be just and fair to nullify the agreement of the parties to a contract"); *In re Schafer's Bakeries*, 155 F. Supp. 902, 907 (E.D. Mich. 1957) (stating that "the validity and enforceability of these agreements for payment of attorney fees and expenses must be determined under applicable state law" and applying *Security Mortgage* analysis); *see also* Gadsden and Yamasaki, *Recovery of Attorney Fees as an Unsecured Claim*, 114 BANKING L.J. 594, 598-600 (1997) ("In cases decided under the Bankruptcy Act, the higher courts consistently held that attorney fees were allowable even as unsecured claims in bankruptcy."); *LeLaurin v. Frost Nat'l Bank*, 391 F.2d 687 (5th Cir. 1968) (holding that amount allowed by referee as reasonable attorneys' fee was binding as between holder and trustee in bankruptcy).

Similarly, following *Security Mortgage*, courts allowed claims for attorneys' fees incurred in litigating federal bankruptcy issues. For example, in *United Merchants & Mfrs. Inc. v. Equitable Life Assurance Soc'y (In re United Merchants & Mfrs., Inc.)*, 674 F.2d 134 (2nd Cir. 1982), the debtor executed agreements with two creditors that contained provisions obligating the debtor to pay the creditors' costs of collection, including attorneys' fees. After the debtor filed for bankruptcy, the creditors incurred attorneys' fees both before the debtor filed for bankruptcy and subsequently during the bankruptcy proceedings in connection with pursuing and protecting their rights in the bankruptcy court (including the

litigation of bankruptcy issues). The bankruptcy court disallowed the fees incurred in protecting their rights in the bankruptcy proceedings. Following *Security Mortgage*, the Second Circuit reversed, concluding generally that a claim for attorneys' fees is allowable in bankruptcy, and specifically that the portion of the fees that the creditors incurred in pursuing and protecting their rights in the bankruptcy court were also allowable. *Id*. at 137-139; *see also In re Ferro Contracting Co.*, 380 F.2d at 120 ("[I]t is not necessary to determine whether these services were rendered prior to bankruptcy. This is so because no matter when or how rendered, such fees if reasonable and if permitted by local law are assertable according to the contractual stipulation of the parties.").

When Congress enacted the Bankruptcy Code in 1978, it replaced the concept of a "provable debt" with the definition of "claim" appearing in section 101(5). Congress likewise enacted section 502 to provide for the allowance of claims generally, and the disallowance of certain specific claims enumerated in the section. 11 U.S.C. § 502; *see also* 4 COLLIER ON BANKRUPTCY ¶ 502.LH[1], at 502-82.1 (15th ed. rev. 2006). Under the Code, the concept of an allowable "claim" is broader than the concept of a provable debt under former section 63. *See* 2 COLLIER ON BANKRUPTCY ¶ 101.05[1], at 101-38 (15th ed. rev. 2006) ("The Code defines the term 'claim' much more broadly in section 101(5) than under previous law."). Further, the definition of "claim" in section 101(5) leaves untouched the principle that this Court articulated in its decision in *Butner* that state law determines the substance of a creditor's claim. 440 U.S. at 54-55; *see also Vanston*, 329 U.S. at 161-62.

There is simply no reason to conclude that Congress intended to alter the pre-Code practice of allowing claims for attorneys' fees that are valid under state law, including fees incurred in litigating bankruptcy issues. Accordingly, the Court should conclude that this practice endures under the Code.

E. The *Fobian* Rule Conflicts With The Fundamental Bankruptcy Policy of Equality Of Distribution.

The *Fobian* rule is further contrary to the fundamental bankruptcy policy of equality of distribution among creditors,

implemented through the Code's claims-processing provisions. *See Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, ___ U.S. ___, 126 S.Ct. 2105, 2109 (2006) ("the Bankruptcy Code aims, in the main, to secure equal distribution among creditors"); *Young v. Higbee Co*., 324 U.S. 204, 210 (1945) ("one of the prime purposes of bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets"); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930) ("The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate"); *see also Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (noting continued policy of equality of distribution under the Bankruptcy Code). Obviously, to the extent that Travelers is unable to recover anything on its claim for its attorneys' fees, it will not share ratably in the debtor's assets in spite of the otherwise valid nature of its claim.

If Travelers is to be foreclosed from all recovery on its claim, that result should stem from an express provision of the Bankruptcy Code that prescribes the relevant rule of preclusion, not a judge-made rule that is not based on any actual provision of federal bankruptcy law or necessary to its implementation. *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952) ("The theme of the Bankruptcy Act is 'equality of distribution', . . . and if one claimant is to be preferred over others, the purpose should be clear from the statute.") (quoting *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941)). Because no such rule of preclusion properly exists, Travelers is entitled to its ratable share.

F. The *Fobian* Rule Is Impractical.

The *Fobian* analysis is further in error because it compels an impractical standard for claims allowance. Many (if not most) disputes in bankruptcy involve the litigation of both state and federal issues because, whereas claims typically arise under state law, the bankruptcy rules and procedures employed to process them are federal in nature. For example, litigation over the debtor's assumption of a lease under section 365 of the Code, 11 U.S.C. § 365, typically involves not only consideration of state-law issues surrounding the validity and terms of the lease itself, but also consideration of the federal bankruptcy rules of assumption

and rejection set forth in the statute. *In re Stoltz*, 197 F.3d 625, 629-30 (2d Cir. 1999) (in analyzing whether debtor could "assume" lease under section 365, the court relied upon state law, stating: "because property interests are created and defined by state law, federal courts have looked to state law to determine a debtor's interests"). Under *Fobian* and its progeny, a creditor may recover fees incurred in litigating the state law issues, but not those arising under section 365. *E.g.*, *Renfrow*, 232 F.3d at 693-94 (concluding that attorneys' fees incurred in adjudicating certain controversies involving state law issues would be allowed, while attorneys' fees incurred in adjudicating other controversies involving bankruptcy issues would not be, and requiring bankruptcy court to sort this out); *Hashemi*, 104 F.3d at 1126-27 (same); *Baroff*, 105 F.3d at 442-43 (same). Yet, in most instances in bankruptcy cases, it will be nearly impossible to differentiate meaningfully fees incurred in litigating one set of issues from the other because they are typically intertwined. This difficulty presents an obvious and time-consuming administrative burden, effectively undermining the efficiency of bankruptcy proceedings as a whole.

An important goal of bankruptcy law is administrative efficiency. *Hoseman v. Weinschneider*, 322 F.3d 468, 475 (7th Cir. 2003) ("The administration of bankruptcy estates has twin goals of maximization of realization on creditors' claims and of prompt and efficient administration of the estate.") (citation omitted); *Lebovits v. Scheffel (In re Lehal Realty Assocs.)*, 101 F.3d 272, 275 n. 5 (2d Cir. 1996) (noting that Congress's "overall goal" in enacting the Bankruptcy Code was "to create a more efficient procedure for administering bankruptcies"). Because the *Fobian* rule obviously frustrates this goal, it is unsound.

G. Application Of The *Fobian* Rule Leads To Absurd Results.

As applied, the Ninth Circuit's *Fobian* rule also leads to absurd results. This is perhaps best illustrated by the result reached in *DeRoche v. Ariz. Industrial Comm'n*, 434 F.3d 1188 (9th Cir. 2006).

During the course of the DeRoches' bankruptcy proceeding, a creditor, the Arizona Industrial Commission ("Commission"), pursued civil litigation in the bankruptcy court seeking a determination that the Commission's claim against the DeRoches constituted a priority, non-dischargeable debt -- meaning that the obligation should be paid ahead of other claims against the DeRoches, and that the DeRoches should continue to be responsible for the obligation notwithstanding their general discharge in bankruptcy. After the Commission was unsuccessful in the litigation, the DeRoches sought to recover from the Commission, pursuant to Arizona Revised Statutes § 12-348, their attorneys' fees incurred in defending the litigation. Section 12-348 directs that, if the State of Arizona (including one its agencies) is unsuccessful in litigation that it has brought against a party, the party shall recover its attorneys' fees from the State (or agency). *See* ARIZ. REV. STAT. § 12-348.

Applying its *Fobian* rule, the Ninth Circuit held that, notwithstanding section 12-348, the DeRoches could *not* recover their attorneys' fees from the Commission because the priority and non-dischargeability issues litigated in the bankruptcy court were questions of federal bankruptcy law. The Ninth Circuit concluded that state law cannot "create a new federal right of attorney fee recovery in this context," 434 F.3d at 1192, and that, because federal law does not independently validate the state rule, "no [attorneys'] fees are available for litigation of substantive federal bankruptcy issues," *id*. In other words, the Ninth Circuit reached the absurd conclusion that, as a matter of general federal common law, a State cannot direct that its *own* agency may be liable to an opposing party for attorneys' fees incurred in the agency's unsuccessful litigation of federal issues. This result is obviously unsound, and underscores the erroneous nature of the Ninth Circuit's rule.

H. The *Fobian* Rule Is Inequitable.

Finally, foreclosing Travelers from any recovery on its claim would be inequitable. It is certainly true that not all unsecured creditors enjoy the benefit of a contractual right to attorneys' fees. It is also true that disallowing a creditor's contractual right to attorneys' fees may have the effect of equalizing treatment among unsecured creditors by eliminating a contractual right enjoyed by some. But "[e]quality among creditors who have lawfully bargained for different treatment is not equity but its opposite." *Chemical Bank v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) (Friendly, J., concurring); *see also United Merch. & Mfrs.*, 674 F.2d at 137 ("We cannot agree that the policy of equitable distribution renders an unsecured creditor's otherwise valid contract claim for collections costs unenforceable in bankruptcy.").

Moreover, as noted, the *Fobian* rule does not bar the allowance of *all* attorneys' fees, just those incurred in litigating bankruptcy issues. So the rule cannot truly be justified as "equalizing" treatment in bankruptcy. In addition, the rule unjustly enriches debtors such as PG&E by permitting them to avoid an obligation that they could not avoid outside the bankruptcy context. *See Butner*, 440 U.S. at 55 (a longstanding policy of bankruptcy law is to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy") (citing *Lewis v. Mfrs. Nat'l Bank*, 364 U.S. 603, 609 (1961)).

Again, if Travelers is to be denied its claim for attorneys' fees, this result should follow from an express provision of the Bankruptcy Code. Because it does not in this case, it is unsound.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision below.

Respectfully submitted,

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