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REASONABILITY OF A CREDITOR'S CLAIM FOR ATTORNEYS' FEES

ABSTRACT

Under the Bankruptcy Code, bankruptcy judges are generally given the power to limit claims for attorneys' fees to a "reasonable" amount. If an attorney for the debtor or an attorney for a creditor's committee tries to collect unreasonable fees from the debtor's estate, the judge can disallow them, preserving the valuable and finite resources of the estate. Yet, the Code does not extend the judge's power to limit claims for attorneys' fees made by creditors. Generally speaking, creditors are not able to collect their attorneys' fees from the debtor's estate. However, in Pacific Gas and Electric's (PG&E) 2019 bankruptcy case, an unusual combination of facts required the debtor to pay the attorneys' fees of many of their creditors. If a creditor submitted a claim for unreasonable attorneys' fees, judges would not have the power to disallow these fees. These attorneys could therefore collect exorbitant fees at the expense of other creditors, and judges would have no mechanism to control this behavior.

This Comment advocates for an amendment to the Code that gives judges the power to restrict all unreasonable claims for attorneys' fees. This amendment would solve two issues. First, the amendment would clarify that a creditor can submit claims for their attorneys' fees when a state statute requires the debtor to pay these fees. While most jurisdictions allow a creditor's claim to include their attorneys' fees, a minority of bankruptcy courts do not allow these claims. The minority position is inconsistent with the Code. Therefore, this amendment to the Code would clarify that the Code does not disallow a creditor's claims for attorneys' fees. Second, the amendment would give judges the new power to control unreasonable claims for a creditor's attorneys' fees. This power would ensure that all claims including attorneys' fees are treated the same and that creditors' attorneys, in rare cases like the PG&E case, could not take advantage of this hole in the Code. Judges need a mechanism to control all claims that include attorneys' fees, no matter how infrequent the situation.

INTRODUCTION

A. *Introduction to Attorneys' Fees*

The bankruptcy court is a court of equity. Bankruptcy courts are guided by equitable principles, tasked with exercising discretion to safeguard the public interest, so long as their acts are consistent with the provisions of the Bankruptcy Code.¹ Debtors who find themselves in bankruptcy rarely have the resources to repay all of their creditors. The Code provides mechanisms to repay these creditors fairly. While some of the debtor's resources are owed to creditors who existed before the debtor filed for bankruptcy, the debtor must use some of these funds to repay actors who did work on behalf of the debtor during the bankruptcy process. These actors include attorneys who are owed fees for the services they provide in the bankruptcy case. These attorneys will be paid from the same pile of money as all other creditors to whom the debtor owes money. Therefore, every dollar the court pays an attorney is another dollar taken away from the creditors who are simply trying to recover what they were already owed by the debtor. On the other hand, without strong representation by an attorney, creditors will be unable to recover any amount from the debtor. As a result, the subject of these attorneys' fees awards "is perhaps the most delicate issue which a bankruptcy court must consider."²

Bankruptcy courts generally have discretion in determining the amount of attorneys' fees awarded, so long as the courts are acting within the confines of the Code.³ When bankruptcy attorneys representing the debtor apply for payment from the debtor's limited funds, the Code specifies that their payment must always be reasonable.⁴ The Code also requires reasonability of fees being paid to the attorneys who represent committees in bankruptcy.⁵ But, a similar blanket provision for attorneys of creditors is missing from the Code. Instead, the Code is silent for creditors' attorneys and does not provide bankruptcy judges with any mechanisms to limit unreasonable claims by creditors' attorneys. Because "every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors," bankruptcy courts should work to

¹ SEC v. U.S. Realty & Improvement Co., 310 U.S. 434, 455 (1940).

² *In re Atwell*, 148 B.R. 483, 487 (Bankr. W.D. Ky. 1993); *see generally In re Bush*, 131 B.R. 364, 365 (Bankr. W.D. Mich. 1991) (court has duty to review fees even when no objection raised by any party).

³ *In re First Colonial Corp. of America*, 544 F.2d 1291, 1298 (5th Cir. 1977).

⁴ 11 U.S.C. § 503(b)(4) (2019).

⁵ *Id.*

prevent inequitable recovery of funds from all attorneys, including the attorneys of creditors.⁶

B. Fee-Shifting Creditor's Attorneys' Fees

A Code provision about a creditor's attorneys' fees would be inapplicable in most bankruptcy cases. Generally speaking, the attorneys' fees of creditors will not be paid by the debtor. The fees will instead be paid by that creditor outside of the bankruptcy forum. Under the American Rule, there is generally no fee-shifting, meaning that both parties bear the burden of paying their own attorneys' fees.⁷ But, there are some ways to overcome the American Rule. If the American Rule is overcome in a bankruptcy case, the debtor will be required to pay that creditor's attorneys' fees.⁸

If a creditor is able to overcome the American Rule, she is able to include the contingency fees of her attorneys as a line-item on her proof of claim in bankruptcy. This line-item exists on the creditor's prayer for relief at the end of her proof of claim.⁹ When listing the total amount of her claim, the creditor must indicate that the amount of the claim "includes interest or other charges," and then "attach [a] statement itemizing interest, fees, expenses, or other charges required by Bankruptcy Rule 3001(c)(2)(A)."¹⁰ This itemized statement includes all damages the creditor is requesting as a part of her claim.

Creditors in bankruptcy are not always individuals in a business relationship with the debtor. In some cases, these creditors are involved in personal injury or mass tort litigation with the debtor. These tort victim creditors often set up contingency fee arrangements with their attorneys.¹¹ In these arrangements, the attorney is only paid if the tort victim's case wins at trial. The attorney is then paid a percentage amount of the tort victim's award, an amount which is often substantially higher than the recovery in cases without contingency fee arrangements.¹² In cases where these large fees were imposed on the debtor-

⁶ *In re Pettibone Corp.*, 74 B.R. 293, 299 (Bankr. N.D. Ill. 1987).

⁷ *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 448 (2007); *see, e.g., In re Lane Poultry of Carolina, Inc.*, 63 B.R. 745, 750 (Bankr. M.D.N.C. 1986).

⁸ *See* FED. R. BANKR. P. 2016 (fee-shifting attorneys' fees clauses are generally viewed as a means of indemnifying a creditor for costs actually incurred in collecting debts, as opposed to being viewed a penalty for the debtor).

⁹ *See, e.g., Proof of Claim at 66, Thomas Adams v. PG&E*, No. CGC-19-573195 (Cal. S. Ct. filed Apr. 13, 2019) [hereinafter *Adams Proof of Claim*] ("Attorneys' fees as allowed under Code of Civil Procedure § 1021.5").

¹⁰ *E.g., id.* at 2.

¹¹ *See City of Burlington v. Dague*, 505 U.S. 557, 560-61 (1992).

¹² *In re W. Real Estate Fund*, 922 F.2d 592, 597-98 (10th Cir. 1990).

business, the costs have driven the businesses to file for bankruptcy¹³ and have reduced the available compensation for other creditors (including the victims themselves).¹⁴

C. Case Study: The 2019 PG&E Bankruptcy

One of these mass tort bankruptcy cases, Pacific Gas and Electronic Company (“PG&E”), was filed in 2019.¹⁵ PG&E was charged with causing a series of California wildfires in 2017. These wildfires resulted in both the loss of life and property for many California citizens at an estimated \$30 billion in liability.¹⁶ The potential liability for PG&E arises primarily because of a unique California statutory doctrine known as “inverse condemnation.”¹⁷ This doctrine has its roots in the United States Constitution’s takings clause.¹⁸ The takings clause requires government units to award compensation when they take or damage private property.¹⁹ Because courts have extended this power of eminent domain to private utilities companies like PG&E, these companies also must assume the risk of liability for any damages caused by the taking of private property.²⁰ The doctrine of inverse condemnation creates strict liability for these private utility companies, as these companies are responsible for any damages caused, regardless of any fault or lack of foreseeability on the part of the company.²¹

As part of the inverse condemnation doctrine, entities that cause damages to private citizens are also required to pay the attorneys’ fees of these citizens.²² Therefore, California’s inverse condemnation doctrine is an example of a fee-shifting statute that overcomes the default American Rule. This statute comes into play in situations like the California wildfires, as there are a number of

¹³ See Solomon Genet, *Your Contingency Fee May Be at Risk if Your Client Files for Bankruptcy*, DAILY BUS. REV. (Oct. 18, 2017), <https://melandrussin.com/app/uploads/2018/04/MRB-DBR-Yourcontingencyfeemaybeatriskifyourclientfilesforbankruptcy-mediaclip-10.18.171.pdf>.

¹⁴ Alan N. Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2045 (2000).

¹⁵ *In re PG&E Corp.*, 2019 Bankr. LEXIS 1706, at *5 (Bankr. N.D. Cal. May 28, 2019).

¹⁶ George Avalos, *PG&E Must Face Tubbs Wildfire Victims in State Court: Bankruptcy Ruling*, THE MERCURY NEWS (Aug. 18, 2019, 7:50 PM), <https://www.mercurynews.com/2019/08/16/pge-must-face-tubbs-wildfire-victims-in-state-court-bankruptcy-ruling/>.

¹⁷ CAL. CIV. PROC. CODE § 1036.

¹⁸ League of California Cities, *Inverse Condemnation Fact Sheet*, CALIFORNIA STATE ASSOC. OF COUNTIES, https://www.counties.org/sites/main/files/file-attachments/inverse_condemnation_fact_sheet_league_csac.pdf (last visited Oct. 4, 2020).

¹⁹ *Id.*

²⁰ *Id.*

²¹ See *id.*

²² CAL. CIV. PROC. CODE § 1036.

victims who want compensation for their damages as a part of a large mass tort lawsuit. Creditors will primarily use contingency agreements with their attorneys in these mass tort cases, leading to a high proportion of recovery for attorneys. Due to the strict liability in inverse condemnation and the fact that this matter is being handled by a bankruptcy judge instead of a jury trial, there is no risk of non-recovery for tort victims in the PG&E case. The creditors' attorneys in the PG&E case will likely gain an unjust windfall because the usual risk of non-recovery in contingency cases is absent in the PG&E case. The Code does not cover this unique situation where the debtor is required to pay the tort victim's attorneys' fees. Therefore, the bankruptcy court in the PG&E case likely will not have any power under the Code to review these claims for attorneys' fees.

If a creditor submitted a claim for unreasonable attorneys' fees, the debtor's estate would be required to pay this unreasonable claim at the same pro rata proportion as the legitimate claims of tort victims with actual injuries. In this situation, the tort victim's attorneys are able to take advantage of two parties. Not only can they take advantage of the tort victim through an unfair fee arrangement, but they are also able to unjustly take resources from the debtor's estate without any review by a bankruptcy judge. For a court of equity, this is an inequitable solution.²³

D. Roadmap

This Comment will discuss how the Code's provisions for paying a creditor's claim for attorneys' fees are underdeveloped. Because the Code lacks clear instruction on how to treat claims for a creditor's attorneys' fees, bankruptcy judges lack the explicit power to review unreasonable claims by a creditor for their attorneys' fees, even though these judges can review and cap the fees of all other attorneys. The 2019 PG&E bankruptcy case will be a case study for how this rare problem can arise in bankruptcy. There are a number of possible outcomes from the PG&E case, many of which will be analyzed through this Comment; however, this Comment will not continue to track the case's ongoing status. While the California court may resolve the attorneys' fees issue in the PG&E case through judge-made determinations, this gap in the Code would still exist for future cases until Congress or the Supreme Court resolves the issue.

²³ *Infra* Section II, A.

This Comment will make two primary arguments. First, while a minority of courts have argued that creditors' attorneys can never submit claims for their fees, this Comment argues that the Code does permit creditors' attorneys to submit claims for their fees. So long as a creditor's claim for attorneys' fees is enforceable under the relevant non-bankruptcy law,²⁴ the Code does not prohibit attorneys who represent creditors from submitting a line-item for their fees within the creditor's claim. Second, because creditors' attorneys are allowed to submit line-items for their fee claims under the Code, this Comment argues that there should be an amendment to the Code providing bankruptcy judges with a mechanism to control these claims. These judges already have the power to review all other claims for attorneys' fees, as bankruptcy courts have broad discretion in determining the amount of attorneys' fees to be awarded.²⁵ Because creditors' attorneys are rarely allowed to attach line items for their fees to creditors' claims, Congress may not have anticipated this rare situation where they would need to give judges the power to review this portion of a claim. By leaving this out of the Code, Congress created a gap in how to treat claims by creditors' attorneys for their fees. This gap in the Code could lead to inequitable treatment of attorneys in the PG&E case. The gap could also deprive other more deserving claimants of payment from the estate, while giving creditor's attorneys a windfall at the expense of all other unsecured creditors—including the injured tort victims themselves.²⁶ If judges could prevent payment of unreasonable attorneys' fees there would be more money in the estate. It is the "province of Congress to correct statutory dysfunctions and to resolve difficult policy questions embedded in the [Code]."²⁷ Therefore, Congress should amend the Code to provide bankruptcy judges with the power to limit a creditor's claim for their attorneys' fees if this portion of the claim is unreasonable.

I. BACKGROUND LAW

A. *Mechanics of Paying Attorneys' Fees in Bankruptcy*

To understand how the bankruptcy court in the PG&E case might handle a tort-victim creditor's claim for his attorneys' fees, there are a number of claim allowance issues we must first resolve. The attorneys' fees will be permitted as

²⁴ 11 U.S.C. § 502(b)(1) (2019); *see* *Butner v. United States*, 440 U.S. 48, 55 (1979).

²⁵ *In re First Colonial Corp.*, 544 F.2d 1291, 1298 (5th Cir. 1977).

²⁶ *See generally* Resnick, *supra* note 14 at 2050 (the bankruptcy system has a goal of providing equal treatment among similar situated claimants).

²⁷ Michael L. Cook, *Court Wrongly Disallows Lender's Post-Bankruptcy Legal Fee*, LAW360 (Dec. 8, 2017, 4:59 PM), <https://www.srz.com/images/content/1/5/v2/154014/Law360-Court-Wrongly-Disallows-Lender-s-Post-Bankruptcy-Legal-Fe.pdf>.

a claim in bankruptcy, and we must understand the status of that claim to know whether the claim is allowed or disallowed under the exceptions in section 502(b)(1)–(9) of the Code. This decision requires a multi-step analysis. First, the court must decide whether there is a claim by a creditor. Second, the court must decide the status of the claim. Third, the court will use the preceding information to decide whether the claim is allowed or disallowed. Fourth, if the claim has been allowed, the court will decide whether the claim should remain at unsecured status or be elevated to secured status.

1. *The Creditors Will Have a “Claim” for their Attorneys’ Fees*

Creditors must first get their claims approved through the claim allowance process to be eligible for distributions from a debtor. The first step of this process is filing a Proof of Claim.²⁸ The Code broadly defines a claim as any “right to payment” regardless of whether that right is reduced to a judgment, fixed or contingent, matured or unmatured, or secured or unsecured.²⁹ While the status of a claim—contingent, unmatured, or unsecured—may have an effect on how it gets paid as the bankruptcy progresses, the claim’s status does not matter at the initial filing stage.³⁰ Therefore, while the tort victims do not yet have a judgment against PG&E, this does not affect a tort victim’s ability to file a Proof of Claim in bankruptcy. On this form, the creditor writes the total amount of the claim.³¹ If the total amount of the claim includes other interests or charges, the form requires creditors to attach a statement itemizing these fees.³² In one Proof of Claim filed by a tort victim for the PG&E bankruptcy case, this itemized statement included “attorneys’ fees calculated at 33.33% of \$832,000.00 estimated value for property damages recoverable under the doctrine of inverse condemnation.”³³

2. *The “Status” of the Creditor’s Claims for Attorneys’ Fees*

Second, after the court has established that there is a claim, the judge must decide the status of this claim. This label helps the judge when he eventually must decide whether the claim is allowed or disallowed.³⁴

²⁸ 11 U.S.C. § 501 (2019).

²⁹ *Id.* § 101(5)(a).

³⁰ *See generally In re Hambley*, 329 B.R. 382, 395 (Bankr. E.D.N.Y. 2005) (proof of claim is prima facie valid).

³¹ *E.g.*, Adams Proof of Claim, *supra* note 9, at 66.

³² *E.g.*, Adams Proof of Claim, *supra* note 9, at Attachment A.

³³ *Id.*

³⁴ *See generally* 11 U.S.C. § 502 (providing the grounds for claim allowance).

a. Pre-Petition and Post-Petition Claims

In bankruptcy, only “creditors” can file claims.³⁵ A creditor is an entity with a right to payment against the debtor that arose before the debtor filed a petition for bankruptcy relief.³⁶ These rights to payment are known as “pre-petition” claims.³⁷ The tort victims in the PG&E case are creditors because the California inverse condemnation statute gave the tort victims a right to payment against PG&E at the moment they were injured by the wildfires.³⁸ Therefore, the tort victims possess pre-petition claims against PG&E because their right to payment existed before the debtor filed for bankruptcy relief.³⁹ On the other hand, if a tort victim was injured after a debtor filed her petition for bankruptcy, then the tort victim would possess a “post-petition” claim. This chronological distinction between pre-petition and post-petition claims becomes more complex when layering in the contingent status of a claim.

b. Contingent Claims

The contingent status of a claim does not provide grounds to disallow a claim in bankruptcy.⁴⁰ A contingent claim is a claim in which the claimant’s right to payment depends on the occurrence of a future event.⁴¹ Contingent claims can arise both pre-petition and post-petition. A claim for attorneys’ fees is a contingent claim that generally arises pre-petition. In a bankruptcy case, an attorney works for a creditor—filing the claim, litigating issues of bankruptcy—after the debtor files for bankruptcy. In some situations, these fees were agreed upon in a contract signed before the debtor filed for bankruptcy. For example, if the creditor and debtor had a working relationship pre-bankruptcy, part of their pre-bankruptcy contract may have stated that if the debtor ever ended up in bankruptcy, the debtor would pay attorneys’ fees incurred by the creditor. Therefore, the creditor’s right to payment in this situation is a “contingent right to post-petition attorneys’ fees.”⁴² The right to payment is contingent because the fees depend on the debtor entering into bankruptcy. The right to payment of fees is incurred post-petition because the attorneys’ fees are incurred through an attorneys’ services in the bankruptcy process. But, the fact that these fees were

³⁵ *Id.* § 101(10)(A).

³⁶ *Id.*

³⁷ *E.g., id.* § 507.

³⁸ *See* CAL. CONST. art. I § 19(a).

³⁹ *See* 11 U.S.C. § 101(10)(A).

⁴⁰ *Id.* § 502(b)(1).

⁴¹ *See generally id.* § 101(5)(A) (noting that contingent claims constitute claims in bankruptcy proceedings).

⁴² Cook, *supra* note 27.

incurred during a post-petition period is irrelevant for determining when the *right* to payment for these fees arose.⁴³ Because this contractual right to the creditor's attorneys' fees was agreed upon before the debtor filed the petition for bankruptcy, the creditor's attorneys gained their right to payment pre-petition, making this a pre-petition claim. Therefore, fees incurred through attorney services conducted post-petition, under a pre-petition contract right, are known as pre-petition contingent claims.⁴⁴ While the attorneys' fees are incurred through litigation occurring post-petition, the contingent right to these post-petition fees existed pre-petition because of the contractual right to the fees.⁴⁵

Tort-victim creditors generally will not have these sorts of pre-petition contractual agreements with the debtor. Commercial contracts between sophisticated businesses often have provisions permitting lenders to recover their attorneys' fees if they are trying to collect a debt that is in default.⁴⁶ In bankruptcy, it is not unusual to see claims for a creditor's attorneys' fees based on these pre-petition contractual agreements. However, unlike business creditors, the tort victims' relationship with the debtor was involuntary, beginning when the debtor committed the tortious act. Therefore, while the tort victims might have a right to payment for their injuries, in most cases they will not have an accompanying pre-petition right to their attorneys' fees because the tort victims' creditors did not have the chance to negotiate this right with the debtor.

The PG&E bankruptcy presents the unique situation where a creditor's attorneys' right to payment of their fees exists because of an applicable state statute, instead of a pre-petition contractual right.⁴⁷ Under the California inverse condemnation statute, tort victims are given the right to be compensated for their injuries.⁴⁸ The statute also provides for fee-shifting of any attorneys' fees incurred by the creditor. The tort victims' right to payment for both their injuries and their attorneys' fees arises simultaneously at the time of injury. Therefore, the tort victims in PG&E possessed this statutory right to payment of attorneys' fees, pre-petition, and therefore have a pre-petition claim.⁴⁹

⁴³ See *In re S. Side House, LLC*, 451 B.R. 248, 262 (Bankr. E.D.N.Y. 2011).

⁴⁴ See *Sec. Mortgage Co. v. Powers*, 278 U.S. 149, 156 (1928).

⁴⁵ *Id.* at 156; see *In re S. Side House, LLC*, 451 B.R. at 262.

⁴⁶ RICHARD F. BROUDE, REORGANIZATIONS UNDER CHAPTER 11 OF THE BANKRUPTCY CODE § 6A.02 (1986).

⁴⁷ See CAL. CONST. art. I § 19.

⁴⁸ See generally CAL. CIV. PROC. CODE § 1036 (noting the costs incurred in attempting to recover compensation for injuries is also included).

⁴⁹ See *In re Cohen*, 191 B.R. 599, 609 (D.N.J. 1996) ("the non-compensatory aspect of the award in this case was codified and therefore entirely foreseeable by the debtor at the time he made the false representations

For the purposes of this Comment, the discussion will not address what happens if any tort victims are injured after PG&E files their petition for bankruptcy. In many mass-tort cases, such as asbestos litigation,⁵⁰ plaintiffs continue to be injured as the bankruptcy process occurs. Because the injuries themselves arose post-petition, they are no longer contingent pre-petition claims. While there is a live debate about the allowance of post-petition attorneys' fees,⁵¹ this Comment will limit the discussion to the recovery of pre-petition attorneys' fees for the sake of simplicity.

c. Unmatured Claims

An unmatured claim is a claim in which a right to payment is owed to a creditor, but not yet due to that creditor.⁵² The tort victims' claims are not unmatured because the entire amount of their claim became due at the time of injury. This term will become relevant for this Comment during the discussion of section 506 of the Code in Section II.A.2⁵³ because this provision allows specific creditors to collect their unmatured contract interest and attorneys' fees.⁵⁴

3. A Creditor's Claim for Their Attorneys' Fees Will Be Allowable Under § 502(a) So Long as There Are No Objections Under § 502(b)

After deciding whether a creditor has a claim, the bankruptcy court will then decide whether a creditor's claim should be allowed or disallowed through the analysis provided in section 502 of the Code.⁵⁵ Under section 502(a) of the Code, all claims submitted by creditors are initially deemed "allowed," permitting creditors to receive a distribution from the bankruptcy estate.⁵⁶ If there is no provision within section 502(b) of the Code that disallows the claim,⁵⁷ then the claim will remain allowed.⁵⁸ But if a party objects under this section, stating that one of the provisions from section 502(b)(1)–(9) is applicable, then the claim

to the plaintiffs. In this sense it may properly be seen as the debt he incurred through his conduct, rather than as punishment").

⁵⁰ See, e.g., *In re Johns-Manville Corp.*, 68 B.R. 618 (Bankr. SDNY, 1986) (an example of asbestos litigation).

⁵¹ This debate is known as the 'United Merchant's issue'. See Cook, *supra* note 27 (citing *In re United Merchs. & Mfrs., Inc.*, 674 F.2d 134 (2d Cir. 1982)).

⁵² See 11 U.S.C. §101(5)(A) (2019).

⁵³ *Infra* Section II.A.2.

⁵⁴ 11 U.S.C. §§ 503(b)(4), 506; see *In re Redeker*, 27 B.R. 734, 736 (Bankr. D. Kan. 1983).

⁵⁵ 11 U.S.C. § 502(a)–(b).

⁵⁶ *Id.* § 502(a).

⁵⁷ See *id.* § 502(b).

⁵⁸ *Id.* § 502(a).

may be disallowed in part or in whole to the extent that the objection applies to that claim.⁵⁹

(a) A claim or interest, proof of which is filed under section 501 of this title, is *deemed allowed*, unless a party in interest . . . objects.

(b) . . . If such objection is made, the court . . . shall determine the amount of such claim . . . and *shall allow such claim* in such amount, *except to the extent that* [provisions (b)(1)–(9) apply to the claim].⁶⁰

For example, a claim for “services of an insider or attorney of the debtor” may be disallowed in part under section 502(b)(4) if a party raises the objection that “such claim exceeds the reasonable value of such services.”⁶¹ If the court finds that the claim for services is reasonable, this provision does not apply and the claim will be allowed in full. On the other hand, if the court finds that claim “exceeds the reasonable value of such services,” then the court will disallow the unreasonable portion of the claim.⁶² As a court of equity, the bankruptcy court is therefore able to award these attorneys with less than the amount contracted for between the parties.⁶³ It is important to note that while section 502(b)(4) expressly disallows unreasonable claims for the services of an attorney of the *debtor*, there is no identical Code provision for the services of an attorney of the *creditor*.

4. *Elevation of Allowed Secured Claims*

After a claim is deemed allowed under section 502 of the Code, the bankruptcy court will determine the allowed claim’s secured status under section 506. If a claimant has a lien on the debtor’s property, that creditor’s claim will be elevated to “secured” status to the extent of the value of the property. When there is no property securing the claim, that creditor’s claim remains “unsecured.” There are two primary reasons why the secured status of the claim matters.

First, in a chapter 7 liquidation, which affects the base recovery in other bankruptcy chapters, secured creditors will generally receive full payment on their claims before any unsecured creditor receives a distribution.⁶⁴ Secured creditors have a much better chance of repayment than unsecured creditors

⁵⁹ *Id.* § 502(b).

⁶⁰ *Id.* § 502 (emphasis added).

⁶¹ *Id.* § 502(b)(4).

⁶² *Id.*

⁶³ *In re Kroh Bros. Dev. Co.*, 88 B.R. 997, 1004 (Bankr. W.D. Mo. 1988).

⁶⁴ 11 U.S.C. §§ 725–726.

because the bankruptcy estate has a finite amount of resources to pay back the creditors.

Second, section 506 gives additional benefits to some secured creditors.⁶⁵ Secured creditors generally receive distributions on their claim at an earlier stage than unsecured creditors. But if a creditor's claim is over-secured—meaning the property securing the lien exceeds the value of the claim—then that creditor can receive secured status on both his allowed claim *and* his allowed attorneys' fees.⁶⁶ If a creditor's claim is fully secured—meaning the property value is equal to the value of his claim—he still receives secured status on his claim, but his allowed attorneys' fees will remain at unsecured status. Hence, for the purposes of this Comment, discussion will be limited to the difference between unsecured and over-secured claims for attorneys' fees.

B. Claims for Attorneys' Fees After the Travelers Case

In *Travelers*, the United States Supreme Court established that section 502(b) of the Code did not categorically disallow contractual claims for attorneys' fees.⁶⁷ The creditor and debtor had a contract containing indemnity provisions, which provided that the debtor had to pay the creditor's attorneys' fees in any litigation related to the contract.⁶⁸ The debtor then argued that creditors could not recover attorneys' fees from the debtor while litigating these disputes about the bankruptcy process.⁶⁹ The bankruptcy court, district court, and the Ninth Circuit Court of Appeals agreed with the debtor's position, following the Ninth Circuit precedent in *Fobian*.⁷⁰ Under the *Fobian* rule, all post-petition attorneys' fees were disallowed in bankruptcy, even if a contract enforceable under the applicable state law created a valid claim for these attorneys' fees.⁷¹

⁶⁵ *See id.* § 506(b), stating:

To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

⁶⁶ *Id.*; *see* FED. R. BANKR. P. 2016; *In re Am. Metals Corp.*, 31 B.R. 229, 237 (Bankr. D. Kan. 1983).

⁶⁷ *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 445 (2007). Note that while PG&E was also a litigant in this case, this was a separate bankruptcy filing for PG&E from April 2001.

⁶⁸ *See id.* at 446.

⁶⁹ *See id.* at 447–48.

⁷⁰ *See id.*

⁷¹ *See In re Fobian*, 951 F.2d 1149, 1153 (9th Cir. 1991).

When the creditor appealed this decision to the Supreme Court, the Supreme Court upheld the creditor's claim for attorneys' fees, overruling the Ninth's Circuit's *Fobian* rule.⁷² The Supreme Court stated that the *Fobian* rule was in direct opposition to the logic of section 502(b).⁷³ Under section 502(b), a claim enforceable under state law is only disallowed in bankruptcy if the claim falls within one of the nine exceptions listed in the provision.⁷⁴ While one exception in section 502(b) disallows claims for services of an attorney of the *debtor*,⁷⁵ there is no analogous provision in section 502(b) disallowing *all* claims for services of an attorney.⁷⁶ Yet, in *Travelers*, the Supreme Court declined to answer whether other provisions of the Code might disallow a claim for attorneys' fees.⁷⁷

A minority of courts have used this gap in *Travelers* to hold that section 506 is a claim allowance provision that allows attorneys' fees for over-secured creditors and disallows attorneys' fees for unsecured creditors.⁷⁸ Therefore, the issue of claim allowance for a creditor's attorneys' fees remains unsettled under the current version of the Code. Because it is unclear whether the Code even allows certain claims for a creditor's attorneys' fees in the first place, this Comment will resolve that issue before addressing whether these allowed claims for a creditor's attorneys' fees must also be reasonable.

II. ARGUMENT

As the Code currently stands, there is no provision that disallows a creditor's claim for attorneys' fees.⁷⁹ While a minority of courts have argued that the Code's silence on the issue means that these fees are not allowed,⁸⁰ this position is inconsistent with the Code's treatment of claims more generally. The first part of this section will discuss why the majority view is correct, and that a creditor's claim for attorneys' fees will be allowed in bankruptcy unless the fees are unenforceable under any agreement or the relevant state law.⁸¹ Because

⁷² See *Travelers*, 549 U.S. at 452–53.

⁷³ See *id.* at 452.

⁷⁴ See 11 U.S.C. § 502(b)(2)–(9) (2019).

⁷⁵ *Id.* § 502(b)(4) (emphasis added).

⁷⁶ See *Travelers*, 549 U.S. at 453.

⁷⁷ See *id.* at 455–56.

⁷⁸ See Geoffrey L. Berman & Peter M. Gilhuly, *Recovering Attorneys' Fees and Costs in Bankruptcy Cases*, 19 AM. BANKR. INST. J. 32, 32–33 (2000).

⁷⁹ See 11 U.S.C. § 502(b).

⁸⁰ *E.g.*, *In re Trib. Media Co.*, 2015 Bankr. LEXIS 3973, at *2 (Bankr. D. Del. Nov. 19, 2015); *In re Old Colony, LLC*, 476 B.R. 1, 31–32 (Bankr. D. Mass. 2012).

⁸¹ 11 U.S.C. § 502(b)(1).

creditors' attorneys can attach claims for their fees to the creditor's claim, the second part of this section will discuss why the Code should be amended to give judges the power to restrict these claims to a reasonable amount. While there are a few ways this amendment could be structured, the most effective change would be an expansion of section 502(b)(4). With this amendment, claims for services of all attorneys, not just attorneys of the debtor, would be disallowed to the extent the "claim exceeds the reasonable value of such [attorney] services."⁸² There are many policy reasons supporting this amendment. Creditors' attorneys should not be able to collect a windfall judgment of unreasonable fees, while all other attorneys in bankruptcy are restricted to the reasonable value of the claim for attorneys' fees.

A. *Disputes About the Current Code: The Code Does Not Disallow a Creditor's Claims for Attorneys' Fees*

Creditors' attorneys' fees are allowed in bankruptcy when provided for by an enforceable contract or an applicable state law.⁸³ Generally, the American Rule does not require the debtor to pay the attorneys' fees of their creditors, instead, parties are required to pay their own fees.⁸⁴ But there are a number of mechanisms allowing prevailing parties to overcome the American Rule and shift their fees onto the losing party.⁸⁵ There are two primary mechanisms for fee-shifting: enforceable contracts providing for attorneys' fees and fee-shifting statutes.⁸⁶

Fee-shifting provisions in contracts are not unusual in bankruptcy proceedings.⁸⁷ Occasionally, creditors will have created pre-bankruptcy contracts with the debtor addressing the recovery of legal fees if the parties ever get involved in litigation.⁸⁸ By allowing these claims in bankruptcy, courts are "merely effectuat[ing] the bargained-for terms of the [debtor's pre-bankruptcy contracts]."⁸⁹

⁸² *Id.* § 502(b)(4).

⁸³ *See id.* § 502(b)(1) (A creditor's claim will be allowed, other than to the extent "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured").

⁸⁴ *See Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 448 (2007); *In re Lane Poultry of Carolina, Inc.*, 63 B.R. 745, 750 (Bankr. M.D.N.C. 1986).

⁸⁵ *See Travelers*, 549 U.S. at 448.

⁸⁶ *See e.g.*, CAL. CONST. art. I § 19.

⁸⁷ *See e.g., In re United Merchs. & Mfrs., Inc.*, 674 F.2d 134, 137 (2d Cir. 1982).

⁸⁸ Cook, *supra* note 27 ("At least five [Second, Fifth, Sixth, Ninth and Eleventh Circuits], if not six, circuits have now put to rest the contractual post-bankruptcy legal fee issue").

⁸⁹ *United Merchs.*, 674 F.2d at 137; *see In re Lane Poultry of Carolina, Inc.*, 63 B.R. 745, 750 (Bankr. M.D.N.C. 1986) (the future debtor has therefore consented to the attorneys' fees in advance: the fees are not

On the other hand, it is “relatively rare” to see bankruptcy cases where claims for attorneys’ fees are based on a fee-shifting statute.⁹⁰ Because tort victims will not have pre-petition contracts with the debtor, they generally cannot rely on pre-bankruptcy contracts to collect their attorneys’ fees. Instead, these tort victims must rely on these rare fee-shifting statutes if they are going to overcome the American Rule.⁹¹

If the tort victims filed their injury claims against PG&E outside of bankruptcy, they could take advantage of California’s doctrine of inverse condemnation and collect their attorneys’ fees in court from PG&E.⁹² Even though PG&E has filed for bankruptcy, the result in the bankruptcy court should be no different.⁹³ The bankruptcy claim allowance process will allow these creditors’ claims for attorneys’ fees because the fees have been provided for by the applicable state law of California.⁹⁴

1. Tort Victim’s Claim for Attorneys’ Fees Will be Allowed under 11 U.S.C. § 502

A tort victim’s claim for their attorneys’ fees will be allowed unless a party in interest objects to this claim, citing an exception listed in section 502(b) of the Code.⁹⁵ Most of these section 502(b) exceptions will not be relevant for a creditor’s claim for attorneys’ fees because this type of claim does not implicate an “unmatured interest [or debt],”⁹⁶ a “tax assessed against property of the estate,”⁹⁷ “services of an insider or attorney of the debtor,”⁹⁸ damages resulting from “termination of a lease” or an “employment contract,”⁹⁹ or “late payment . . . [of] an employment tax.”¹⁰⁰ A party in interest also cannot properly object under section 502(b)(9), assuming the tort victim filed his claim timely.¹⁰¹

some arbitrary amount imposed by the court in excess of what a debtor would have agreed to in advance).

⁹⁰ Berman & Gilhuly, *supra* note 78, at 32.

⁹¹ Berman & Gilhuly, *supra* note 78, at 32.

⁹² See 11 U.S.C. § 502(b)(1) (2019); CAL. CONST. art. I § 19.

⁹³ See generally *In re Kroh Bros. Dev. Co.*, 88 B.R. 997, 1003 (Bankr. W.D. Mo. 1988) (“The fact that a lift of stay was never obtained so that MBL could pursue other legal or judicial methods of collection should not prevent it from recovering its attorney fees when the amount was collected through bankruptcy proceedings.”).

⁹⁴ See 11 U.S.C. § 502(b)(1) (the claim is not “unenforceable . . . under any agreement or applicable law”).

⁹⁵ *Id.* § 502(b)(2)–(9).

⁹⁶ *Id.* § 502(b)(2).

⁹⁷ *Id.* § 502(b)(3).

⁹⁸ *Id.* § 502(b)(4).

⁹⁹ *Id.* § 502(b)(6)–(7).

¹⁰⁰ *Id.* § 502(b)(8).

¹⁰¹ See *id.* § 502(b)(9).

Therefore, while the exceptions provided in section 502(b)(2)–(9) have no impact on a creditor’s claim for attorneys’ fees,¹⁰² a party in interest can attempt to object under section 502(b)(1).¹⁰³

If a party objects to a claim under section 502(b)(1), that claim will only be disallowed if it is “unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured.”¹⁰⁴ In other words, the tort victim’s claim for attorneys’ fees would be disallowed if the claim was deemed unenforceable under California’s state law.¹⁰⁵ This provision reflects how the “basic federal rule in bankruptcy is that state law governs the substance of claims.”¹⁰⁶ If there is no relevant intervening principle from bankruptcy law or federal law, the validity of a claim is determined in accordance with the relevant state law.¹⁰⁷

In the tort victims’ case, their attorneys’ fees claims come from California state law of inverse condemnation,¹⁰⁸ showing that their claims are clearly enforceable under the applicable state law.¹⁰⁹ In addition, section 502(b)(1) of the Code establishes that the contingent status of a claim for fees is not a grounds for disallowance.¹¹⁰ This determination is consistent with the decision in *Travelers*, which held that section 502(b) did not categorically disallow a claim for attorneys’ fees.¹¹¹ Therefore, section 502(b) will not present obstacles to plaintiffs in the PG&E case who are including their attorneys’ claims for fees as part of their own bankruptcy claim.¹¹² A bankruptcy judge would therefore allow

¹⁰² See *id.* § 502(b)(2)–(9).

¹⁰³ See *id.* § 502(b)(1).

¹⁰⁴ *Id.*

¹⁰⁵ See *Butner v. United States*, 440 U.S. 48, 55 (1979).

¹⁰⁶ *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 450 (2007).

¹⁰⁷ See *id.* at 450–51.

¹⁰⁸ See CAL. CONST. art. I § 19; *Belair v. Riverside Cty. Flood Control Dist.*, 47 Cal. 3d 550, 558 (1988).

¹⁰⁹ See *In re Dow Corning Corp.*, 456 F.3d 668, 683 (6th Cir. 2006).

¹¹⁰ 11 U.S.C. § 502(b)(1) (2019). The Southern District of New York, however, disagreed with this interpretation of the Code, instead finding:

[C]laimants’ right to attorneys’ fees were contingent upon their . . . obtaining an award of attorneys’ fees in their judgments. Commencement of the bankruptcy proceedings eliminated the possibility that the contingency would ever come to pass. Accordingly, claimants [do not have a] right to payment of their prepetition attorneys’ fees. Without a right to payment, Claimants have no claim.

In re Drexel Burnham Lambert Grp., 148 B.R. 979, 981 (Bankr. S.D.N.Y. 1992) (citations omitted).

¹¹¹ *Travelers*, 549 U.S. at 453.

¹¹² See *Cohen v. De La Cruz*, 523 U.S. 213, 223 (1998).

the tort victims' claims for attorneys' fees to continue, as there is no basis for disallowing this claim.¹¹³

2. *Jurisdictional Split Surrounding 11 U.S.C. § 506*

There are additional obstacles for a creditor who is making a claim for their attorneys' fees in a bankruptcy case. While the Supreme Court in *Travelers* established that section 502(b) did not categorically disallow a creditor's claims for attorneys' fees,¹¹⁴ the Supreme Court declined to answer whether other provisions in the Code would prevent these claims from being allowed against the debtor.¹¹⁵ This gap has led to uncertainty among lower courts, where the success of a creditor's claim for attorneys' fees depends on both the status of the claim and the jurisdiction where the case is filed.¹¹⁶ If a claim is over-secured under section 506(b), the Code explicitly provides that the holder of that over-secured claim "shall be allowed . . . any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose."¹¹⁷ While a majority of courts believe that this provision merely elevates certain over-secured claims, a minority of courts have interpreted this provision to mean that for any creditor's claim that is not over-secured, that claim will be disallowed. The tort victims in PG&E's bankruptcy are involuntary creditors and have no collateral securing their allowed claim.¹¹⁸ Therefore, the tort victims are unsecured creditors who do not fall within the instruction of section 506(b) for over-secured creditors. Depending on the jurisdiction, there are two primary ways a court could rule on the allowance of the unsecured creditor's claim for attorneys' fees.

a. *Minority Point of View of 11 U.S.C. § 506*

Some courts¹¹⁹ have ruled that unsecured creditors are never entitled to assert claims for attorneys' fees.¹²⁰ Courts taking this view note that section 506(b) explicitly provides attorneys' fees for over-secured claims. By implication, these

¹¹³ See 11 U.S.C. § 502(b).

¹¹⁴ See *Travelers*, 549 U.S. at 453–55.

¹¹⁵ See *id.* at 445.

¹¹⁶ See Berman & Gilhuly, *supra* note 78, at 32.

¹¹⁷ 11 U.S.C. § 506.

¹¹⁸ See generally *id.* § 101(37) (defining a lien to obtain a secured claim).

¹¹⁹ *E.g.*, *In re Trib. Media Co.*, 2015 Bankr. LEXIS 3973, at *3 (Bankr. D. Del. Nov. 19, 2015); *In re Old Colony, LLC*, 476 B.R. 1, 32 (Bankr. D. Mass. 2012).

¹²⁰ Note that sometimes these courts only limit post-petition claims for attorneys' fees while allowing pre-petition claims for attorneys' fees, but that this Comment is not exploring that issue. See, *e.g.*, *Summitbridge Nat'l Inv. III, LLC v. Faison*, 915 F.3d 288, 296 (4th Cir. 2019).

courts find that section 502(b) must not provide attorneys' fees to unsecured claims.¹²¹ Otherwise, the fee provision in section 506(b) would be redundant.¹²² These courts point out how Congress explicitly expressed their intent to provide attorneys' fees in a number of other Code provisions: section 330 ("the court may award to the trustee . . . or a professional person . . . reasonable compensation for actual, necessary services"); section 503 (allowing an administrative expense of "reasonable compensation for professional services rendered by an attorney"); and section 523(d) ("the debtors costs of, and a reasonable attorneys' fees for . . .").¹²³ Other than these enumerated exceptions, Congress did not intend for debtors to pay another party's attorneys' fees.¹²⁴ This argument was made in the respondent's brief in *Travelers*.¹²⁵ The Supreme Court in *Travelers* declined to answer whether section 502(b) disallowed an unsecured creditor's claim for contractual attorneys' fees because this issue was raised for the first time on appeal.¹²⁶ If the minority perspective was correct, then unsecured creditors could never file a claim for their attorneys' fees, even if there was a valid contract or state statute providing for those fees.¹²⁷

There are also policy reasons to support this minority interpretation of section 506(b). While the tort victims in the PG&E case can rely on the inverse

¹²¹ See *In re Pride Co., L.P.*, 285 B.R. 366, 375 (Bankr. N.D. Tex. 2002); Laith Hamdan, Note, *Creditor Claims for Postpetition Attorneys' Fees Incurred in Bankruptcy Litigation and the Role of State Law*, 37 CARDOZO L. REV. 2279, 2289 (2016) ("negative pregnant of § 506(b) is that contractually authorized attorneys' fees may not be awarded to those who do not have oversecured claims—that is, unsecured and undersecured creditors.").

¹²² Brief for Appellee-Respondent at 19, *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443 (2007).

¹²³ See *In re Seda France, Inc.*, 2011 Bankr. LEXIS 2874, at *7–8 (Bankr. W.D. Tex. July 22, 2011).

¹²⁴ See *id.* at *9; The Bankruptcy Court for the Western District of Pennsylvania agreed:

Because §506(b) . . . expressly provides for the allowance of postpetition attorneys' fees for oversecured creditors, and neither §506(b) nor any other provision . . . provides for the allowance of such fees for unsecured creditors, it follows that unsecured creditors have no clear entitlement to postpetition attorneys' fees.

In re Glob. Indus. Techs., 327 B.R. 230, 239–40 (Bankr. W.D. Pa. 2005).

¹²⁵ Brief for Appellee-Respondent at 19, *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443 (2007).

¹²⁶ In *Travelers*, the Supreme Court found:

PG&E did not raise these arguments below. . . [W]e ordinarily do not consider claims that were neither raised nor addressed below . . . and PG&E has failed to identify any circumstances that would warrant an exception to that rule in this case. We therefore will not consider these arguments.

Travelers Cas. & Sur. Co. of Am. v. PG&E, 549 U.S. 443, 455 (2007).

¹²⁷ See, e.g., *In re Old Colony*, 476 B.R. 1, 31 (Bankr. D. Mass. 2012); see Trib. Media Co., 2015 Bankr. LEXIS 3973, at *3 (Bankr. D. Del. Nov. 19, 2015) (Denying unsecured creditors their attorneys' fees may not leave creditors without recourse, if they can establish that these services substantially benefitted the bankruptcy estate and are therefore eligible for post-petition administrative expense status under section 503(b)(3)).

condemnation statute to make their claim for attorneys' fees, these fee-shifting statutes are "relatively rare."¹²⁸ In the typical mass tort case, unsecured creditors have no means of recovering their attorneys' fees. Unlike secured creditors, creditors with unsecured claims (such as tort victims) rarely have pre-bankruptcy contracts with the debtor that provide for payment of attorneys' fees. Instead, these unsecured creditors are involuntary creditors, who can only rely on statutes—like California's inverse condemnation statute—for the chance to recover their attorneys' fees.¹²⁹ If only this specific group of unsecured creditors within the class of all unsecured creditors were able to recover their attorneys' fees, this would create a disadvantage for the other unsecured creditors in that class.

The discussion in Laith Hamdan's note provides a helpful illustration of this principle.¹³⁰ In his illustration, there are two creditors. Creditor A is a tort victim who has received a \$20,000 money judgment against the debtor.¹³¹ Creditor B is a credit card company that is owed \$20,000 by the debtor under a credit agreement.¹³² Both parties also incur \$5,000 of fees while litigating their case. Both Creditor A and Creditor B can submit claims for the \$20,000 they are owed. If the bankruptcy estate has \$20,000 to pay its two creditors, each creditor will receive 50% of what they were owed, or \$10,000.¹³³ But suppose Creditor B has a contract with the debtor arranging for reimbursement of any fees incurred in enforcing their agreement. Now, Creditor B is able to submit a claim for \$25,000 while Creditor A's claim remains at \$20,000. *Because creditors receive a 50% pro rata share of what they are owed,*¹³⁴ Creditor B will now recover over \$11,000, having the ability to "increase its claim and recover more of [the debtor's assets] at [the expense of Creditor] A," who now receives less than \$9,000.¹³⁵ In sum, allowing unsecured creditors to assert a claim for attorneys' fees is often against tort victims' best interest.¹³⁶ These policy reasons support the minority interpretation of section 506(b), which would deny all unsecured creditors the right to claim attorneys' fees, even if there was an enforceable fee-shifting contract or applicable state law.

¹²⁸ Berman & Gillhuly, *supra* note 78, at 32.

¹²⁹ CAL. CONST. art. I § 19.

¹³⁰ Hamdan, *supra* note 121 at 2285.

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.* (emphasis added).

¹³⁵ *Id.*

¹³⁶ See generally Corinne McCarthy, Comment, *Creditor's Committee: Giving Tort Claimants a Voice in Chapter 11 Bankruptcy Cases*, 31 EMORY BANKR. DEV. J. 431, 444 (2015) (arguing tort victims should receive their own creditor's committee).

b. *Majority Point of View of 11 U.S.C. § 506*

i. *11 U.S.C. § 506 is Not a Claim Disallowance Provision*

The more dominant view among courts is that unsecured creditors may assert a claim for their attorneys' fees when that claim is provided for by an enforceable contract or state statute.¹³⁷ This approach, followed by multiple circuit courts,¹³⁸ embraces the logic of the Code's claim allowance process more closely. As previously explained, enforceable claims are generally allowed under section 502(a) unless the claim is expressly disallowed under section 502(b).¹³⁹ There is no exception under section 502(b) that differentiates between over-secured, fully secured, and under-secured claims. The only mention of secured status arises in section 506, which is not a claim allowance provision.¹⁴⁰ Therefore, there is no reason to differentiate secured and unsecured claims at the claim allowance stage simply based on their secured status.¹⁴¹

There is also no reason to believe that creditors' claims for attorneys' fees will be disallowed under section 502(b) if they are enforceable under a contract or the applicable state law.¹⁴² There is no provision of section 502(b) that expressly disallows these claims for attorneys' fees. Therefore, the fees would be allowed under section 502(a).¹⁴³ After a claim is allowed, the court would proceed to analyze the claim's secured status under section 506. The trigger for section 506(a) is an "allowed claim of a creditor secured by a lien on property," demonstrating that a pre-requisite to applying this provision is that the claim has already been allowed under section 502.¹⁴⁴ Therefore, section 506(a) could not be part of the initial claim allowance process because creditors must have an allowed claim to even utilize this provision.

The creditor's allowed claim is then broken down into its allowed secured and allowed unsecured components under section 506(a).¹⁴⁵ A creditor's secured claims will receive higher priority than unsecured claims during distribution of

¹³⁷ See Berman & Gilhuly, *supra* note 78, at 32; *Butner v. United States*, 440 U.S. 48, 55 (1979).

¹³⁸ Cook, *supra* note 27.

¹³⁹ *Supra* Section I.A.3.

¹⁴⁰ In order to apply section 506, there must already be an "allowed" claim. 11 U.S.C. § 506(a)(1) ("An *allowed* claim of a creditor . . . is a secured claim to the extent . . .") (emphasis added).

¹⁴¹ See Cook, *supra* note 27.

¹⁴² See 11 U.S.C. § 502(b)(1).

¹⁴³ See *In re Welzel*, 275 F.3d 1308, 1319 (11th Cir. 2001).

¹⁴⁴ 11 U.S.C. § 506(a)(1).

¹⁴⁵ *Id.*

the debtor's estate.¹⁴⁶ In turn, the secured creditor has a higher likelihood of being paid because their claims are being distributed earlier in the bankruptcy process. Under section 506(b), if a claim is over-secured, the creditor also receives this higher distribution priority for any "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose."¹⁴⁷ When discussing reasonable "fees" under section 502(b)(6), the "fees" are understood to include attorneys' fees to the extent enforceable under state law.¹⁴⁸ While the minority of courts argue that this provision disallows all other attorneys' fees, the more consistent view is that section 506(b) simply elevates a claim for reasonable attorneys' fees for over-secured creditors and provides this portion of the claim with secured status. A secured claim receives higher priority in bankruptcy than an unsecured claim. Therefore, attorneys' fees attached to an over-secured claim will also receive this higher priority.

The majority treatment of a creditor's claims for attorneys' fees can be illustrated by the following example. If a creditor had both an over-secured allowed claim and was entitled to attorneys' fees under an enforceable contract or statute, the bankruptcy court would be required to analyze whether the creditor's attorneys' fees were "reasonable" under section 506(b).¹⁴⁹ The reasonable portion of these fees would be elevated to a higher priority claim due to the claim's secured status.¹⁵⁰ The unreasonable portion, on the other hand, should be treated like an unsecured claim.¹⁵¹ The purpose of section 506 is to decide which allowed claims will have this secured status, and thus receive better treatment than an unsecured claim.¹⁵² Therefore, there is little reason to conclude that a claim for unreasonable over-secured fees, reasonable unsecured fees, or unreasonable unsecured fees should be disallowed just because section 506(b) does not expressly provide these claims with secured status.¹⁵³ Instead, these claims will still be allowable as unsecured claims under the provisions of section 502(b).¹⁵⁴

¹⁴⁶ See *id.* § 725–726(a)(1).

¹⁴⁷ *Id.* § 506(b).

¹⁴⁸ See *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 453 (2007).

¹⁴⁹ 11 U.S.C. § 506(b).

¹⁵⁰ See *In re 268, Ltd.*, 789 F.2d 674, 676 (9th Cir. 1986).

¹⁵¹ See *id.* at 678.

¹⁵² See 11 U.S.C. § 725–726.

¹⁵³ See *In re United Merchs. & Mfrs., Inc.*, 674 F.2d 134, 139 (2d Cir. 1982) (finding no law or policy that supports the disallowance of claims for collection costs under an agreement).

¹⁵⁴ See *In re 268, Ltd.*, 789 F.2d at 678.

ii. *Highlighting the Difference Between the Code's Treatment of Creditors' Claims for Attorneys' Fees and Claims for Post-Petition Interest*

There is another reason to believe that the majority view is more consistent with the Code. Section 506(b) affects both a creditor's claim for their attorneys' fees and a creditor's claim for unmatured interest by providing over-secured creditors with elevated claims for allowed post-petition attorneys' fees and unmatured interest. But, historically, courts have argued that section 506(b) was a claim "allowance" provision, meaning a creditor's claims for unmatured interest would only be allowed if the creditor's claim was over-secured under section 506(b), as opposed to merely being elevated if the creditor's claim was over-secured.¹⁵⁵ But, *U.S. v. Ron Pair Enterprises*, clarified that section 506(b) was not an allowance provision because unmatured interest already had an allowance provision, namely section 502(b)(2).¹⁵⁶ Section 506(b) was merely a provision elevating the status of post-petition claims for unmatured interest. When courts view creditors' claims for unmatured interest, they generally deem that no part of these claims are "allowed" or "disallowed" under section 506(b). Because courts do not deem these claims for unmatured interest as "allowed" or "disallowed" under 506(b), courts also should not consider section 506(b) as an allowance provision for creditors claiming attorneys' fees to use section 506(b).

While claims for both attorneys' fees and post-petition interest are provided to over-secured creditors in section 506(b), these two claims are treated differently during the earlier claim allowance process. During the claim allowance process, there is no provision allowing a party to object to a creditor's claim for attorneys' fees. On the other hand, a party can object to "unmatured interest" on a claim, as provided in section 502(b)(2). If this objection is made, the court will disallow any post-petition interest. This is, however, only for the unmatured *interest* associated with a claim; unmatured *claims* are not disallowed according to section 502(b)(1).¹⁵⁷ While claims for unmatured interest were disallowed during the claim allowance process, section 506(b) later seems to provide over-secured creditors with this unmatured "interest on such [allowed

¹⁵⁵ See *Post-Travelers Decisions Continue the Debate Regarding the Allowability of Unsecured Creditors' Claims for Postpetition Attorneys' Fees*, JONES DAY (Sep. 2007), <https://www.jonesday.com/en/insights/2007/10/post-travelers-decisions-continue-the-debate-regarding-the-allowability-of-unsecured-creditors-claims-for-postpetition-attorneys-fees>.

¹⁵⁶ See Blaire Cahn, *The Supreme Court Gets Its Grammar on: Interpreting the Right to Postpetition Interest Under Section 506(b)*, WEIL RESTRUCTURING BLOG (July 3, 2014), <https://restructuring.weil.com/throwback-thursday/u-s-v-ron-pair-enters/> (citing *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989)).

¹⁵⁷ See 11 U.S.C. § 502(b)(1) (the claim will be disallowed if "such claim is unenforceable against the debtor . . . other than because such claim is contingent or unmatured").

secured] claims, and any reasonable fees, costs or charges provided for under the agreement or State statute under which such claim arose.”¹⁵⁸

Before *Ron Pair*, a court could have argued that section 506(b) reverses the effect of section 502(b)(2) for over-secured creditors by allowing their unmatured interest claims, and therefore that section 506 was a claim allowance provision for both unmatured interest as well as attorneys’ fees. But in *Ron Pair*, the Supreme Court held that section 506(b) creates an automatic entitlement to post-petition interest for unsecured creditors, regardless of whether an agreement or state statute provided for that interest.¹⁵⁹ The Supreme Court found that the comma after “interest on such claim” in the text of section 506(b) segregated the “post-petition interest” from the other “reasonable fees and costs provided for within an agreement or state statute.”¹⁶⁰ This finding demonstrates that section 506(b) does not “re-allow” the interest disallowed under section 502(b)(2); the section 502(b)(2) interest remains disallowed. The new interest amounts, which are automatically elevated to secured status under section 506(b), do not have to be provided for by the agreement or statute giving rise to the claim. While not discussed in this Comment, these interests are not considered claims, but instead are administrative expenses, which go through a different allowance process.¹⁶¹

Therefore, section 506(b) does not re-allow the same claims initially made for unmatured interest, but instead gives over-secured claimants a separate right to unmatured interest that existed independent of their initial allowed claim. This potential redundancy issue fixed by *Ron Pair* never arose with the attorneys’ “fees and costs” described in section 506(b), since there is no corresponding disallowance provision from section 502(b). The language of section 506(b) was already clear that the attorneys’ fees and costs described in section 506(b) are not provided as an independent right, as the phrase “provided for under the agreement or State statute under which such claim arose” clearly modifies these fees and costs.¹⁶² Therefore, if an over-secured creditor wants to elevate the status of their over-secured claim for reasonable attorneys’ fees, the claim must already allow for these fees. These claims merely receive their *elevated status* through section 506(b); there is no evidence that this provision affects the *allowance* of these claims.

¹⁵⁸ *Id.* § 506(b).

¹⁵⁹ *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).

¹⁶⁰ *Id.*; *see* 11 U.S.C. § 503(b).

¹⁶¹ *See id.*

¹⁶² *Id.* § 506(b).

3. *By Taking the Majority View That the Code Does Not Disallow Creditors' Claims for Attorneys' Fees, the Code's Gaps Involving Payment of These Fees Become Evident*

Because section 506(b) is not a claim allowance provision, and the majority view is correct that no provision from section 502(b) disallows creditors' claims for attorneys' fees, the Code clearly allows creditors' attorneys' claims for their fees in bankruptcy. Therefore, the tort victims' attorneys' claims will be allowed in the PG&E case because their claims are enforceable under the applicable California inverse condemnation law.¹⁶³ Because the tort victims' claims for attorneys' fees are enforceable under applicable law, their claims will be allowable in bankruptcy unless the Code expressly disallows it.¹⁶⁴ This allowance is inferred because of the absence of a disallowance provision. But this absence of a Code provision creates problems when it comes to a bankruptcy judge's ability to cap any claims by creditor's for unreasonable attorney fee payments. Unlike fee claims made by all other attorneys in bankruptcy, who have a provision authorizing only their "reasonable" fees, there is no analogous provision in the Code for creditor's attorneys. This gap in the Code presumably means that judges have no discretion to cap claims for creditor's attorneys' fees. The second portion of this Section will argue that there should be a reasonability cap on creditor's attorneys' fees and will explain the reasoning for this argument.

B. *Proposed Changes: Inserting a Reasonability Cap for Creditor's Attorneys' Fees*

Currently, the Code is silent as to whether a bankruptcy judge has the power to review a creditor's claim for attorneys' fees. If the judge in the PG&E case attempted to cap a tort victim's claim for attorneys' fees to its reasonable amount, the judge's decision would likely be overruled because "fee arrangements [reached in a non-bankruptcy setting] between [tort victim] claimants and their attorneys lie beyond the jurisdiction of the court."¹⁶⁵ But, if there was a Code provision allowing judges to modify these non-bankruptcy rights, the judges would be able to restrict the creditors' attorneys' claims to their reasonable value.¹⁶⁶

¹⁶³ CAL. CONST. art. I § 19.

¹⁶⁴ See *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 453 (2007).

¹⁶⁵ *In re Johns-Manville Corp.*, 68 B.R. 618, 632 (Bankr. S.D.N.Y. 1986).

¹⁶⁶ See *In re Qmect, Inc.*, 368 B.R. 882, 886 (Bankr. N.D. Cal. 2007) ("[a]bsent a clear provision of the Bankruptcy Code modifying a creditor's nonbankruptcy legal rights, the Court concludes that those rights should be deemed to be left intact.").

This Comment will demonstrate multiple ways to add this reasonability cap to a creditor's claims for attorneys' fees. One proposed solution is that individual states could adopt their own maximum contingency fee rate recovery for contracts and fee-shifting statutes.¹⁶⁷ This solution would ultimately be ineffective, as exemplified by California's inverse condemnation statute.¹⁶⁸ The other possible solutions involve amendments to the Code itself, which this Comment advocates is a more effective way of fixing the problem of unreasonable attorneys' fees in bankruptcy.

1. *Inserting a Reasonability Cap into State Laws*

Through California's inverse condemnation statute, tort victims are able to shift attorneys' fees to the government unit or business who harmed their private property.¹⁶⁹ California's Code of Civil Procedure expands on this statute, stating that when a proceeding involves inverse condemnation, the court shall "reimburse the plaintiff's costs, disbursements, and expenses, including reasonable attorney fees."¹⁷⁰ Therefore, a California court would only allow reasonable damages for attorneys' fees and would not allow a claim for unreasonable damages. Because the source of allowable damages in bankruptcy law is state law, this statute suggests that an unreasonable claim for damages in bankruptcy would not be allowed by the underlying state law.¹⁷¹ While this provision seeks to remedy the problem of unreasonable fees identified in this Comment, the state law's reasonability requirement is insufficient for two reasons.

First, reasonability in the context of bankruptcy is often different from reasonability in the context of state law. In one California inverse condemnation case, the court awarded a plaintiff with the full amount of attorneys' fees provided for in their contingency fee agreement, totaling 40% of plaintiff's recovery.¹⁷² If this case ended up in bankruptcy before the plaintiff was able to collect on their judgment, there would be no mechanism for a judge to limit the attorneys' ability to collect on their fees, even if it came at the expense of other

¹⁶⁷ *E.g.*, *In re W. Real Estate Fund*, 922 F.2d 592, 595 (10th Cir. 1990) ("In Oklahoma, contingency fee contracts over fifty percent are valid and enforceable.").

¹⁶⁸ *See* CAL. CONST. art. I § 19.

¹⁶⁹ *See id.*

¹⁷⁰ CAL. CIV. PROC. CODE § 1036.

¹⁷¹ *See In re W. Real Estate Fund*, 922 F.2d at 595; *Butner v. United States*, 440 U.S. 48, 55 (1979).

¹⁷² *See Pac. Shores Prop. Owners Ass'n v. Dep't of Fish & Wildlife*, 244 Cal. App. 4th 12, 62 (2016); *In re Lane Poultry of Carolina, Inc.*, 63 B.R. 745, 750 (Bankr. M.D.N.C. 1986) (previous fee agreements prevent creditors' attorneys from "neglecting to draft a binding fee agreement with the hope that the Court will later define 'reasonable fee' in more generous and profitable terms than those consented to").

more deserving creditors.¹⁷³ In bankruptcy, there are a finite amount of resources within the estate to be distributed to all creditors. The bankruptcy court should therefore encourage the most equitable payout. If these attorneys' fees cannot be restricted in the bankruptcy forum, they could "becom[e] a tool for wasteful diversion of an estate at the hands of secured creditors who, knowing that the estate must foot the bills, fail to exercise restraint in enforcement expenses."¹⁷⁴

Second, any reasonability limitation prescribed under state law might be redundant in the bankruptcy context. While the validity of claims is dependent on the underlying state law,¹⁷⁵ it is clear under section 506(b) that the bankruptcy court makes its own independent evaluation as to what constitutes reasonable fees.¹⁷⁶ Therefore, if a claim for attorneys' fees was not allowable under state law, but a bankruptcy court finds those fees to be allowed and reasonable, an award for these fees may still be granted.¹⁷⁷ This conclusion reinforces that a reasonability limitation on attorneys' fees within state law is likely an insufficient remedy in the bankruptcy context.

2. *Inserting a Reasonability Cap into the Code*

The preferred method of fixing the problem of unreasonable claims for a creditor's attorneys' fees in bankruptcy is an amendment by Congress to the Code itself. The reasonable portion of these fees would still be allowed, as currently provided in the Code, but this amendment would provide judges with the explicit power to disallow the unreasonable portion of a creditor's attorneys' claim fees. The bankruptcy court is a court of equity and should have the explicit power under the Code to assess *all* claims for attorneys' fees against the debtor to determine their reasonability in the bankruptcy context.¹⁷⁸ The Code plainly

¹⁷³ See generally Resnick, *supra* note 14, at 2061 ("[w]hy should the corporation's financial difficulties, caused primarily by mass tort liability . . . fall solely on the tort victims? Rather [all creditors] should share the pain of the corporation's financial difficulties.").

¹⁷⁴ *In re Wonder Corp. of Am.*, 82 B.R. 186, 189 (D. Conn. 1988).

¹⁷⁵ See *Ferrari v. Barclays Bus. Credit*, 87 B.R. 745, 748 (Bankr. D. Mass. 1988).

¹⁷⁶ See *In re Breedren*, 180 B.R. 802, 808 (Bankr. N.D.W. Va. 1995); *In re W. Real Estate Fund*, 922 F.2d 592, 597 (10th Cir. 1990).

¹⁷⁷ See, e.g., *In re Va. Foundry Co.*, 9 B.R. 493, 497 (W.D. Va. 1981); The *Ferrari* case reached a similar conclusion:

[A]lthough a liquidated damages charge may be reasonable and valid under Connecticut law because it was a reasonable estimate of the damages anticipated when the contract was made, that same charge will be valid and enforceable under § 506(b) only to the extent that the secured party actually incurred damages.

Ferrari, 87 B.R. at 750.

¹⁷⁸ See generally *In re W. Real Estate Fund*, 922 F.2d at 597 ("a federal standard should guide the court in its judgment regarding the reasonableness of such damages in the context of bankruptcy."); Wolohan Lumber

gives bankruptcy judges the power to cap unreasonable claims made by an attorney of the debtor, an authorized committee, the trustee, and all other professional persons—such as accountants or appraisers—hired by the trustee.¹⁷⁹ The Code should give judges the analogous power to cap unreasonable claims made by a creditor for attorneys' fees. Even though it is rare that creditors are able to submit claims with line-items for attorneys' fees, this does not mean that the Code should not cover this specific situation. The remaining portion of this Section will discuss two proposed amendments to the Code, both of which I have crafted, and why those amendments should be implemented.

a. Possible Mechanics of a Code Amendment

In section 502(b)(4), Congress explicitly disallowed unreasonable claims for the services of an attorney, but this provision is only applicable to an attorney of the *debtor*.¹⁸⁰ While section 502(b)(4) is not applicable to the services for an attorney of the *creditor*, there are two important takeaways that can be gathered through an examination of this provision.

First, section 502(b)(4) provides a model for working with unreasonable claims for the services of an attorney. While the applicable state law determines whether attorneys' fees are available as damages,¹⁸¹ the bankruptcy court looks to non-bankruptcy federal law to determine whether there will be a cap on the amount of the state law damages for attorneys' fees.¹⁸² This cap ensures the state law damages are considered reasonable in the context of bankruptcy.¹⁸³ Once the court has determined the reasonable amount of damages, then the claim for services of the debtor's attorney is disallowed to the extent that the fees exceed their reasonable value.¹⁸⁴

Congress did not define reasonable compensation for an attorney within the Code. Therefore, bankruptcy courts must look to federal non-bankruptcy law for

Co. v. Robbins, 21 B.R. 747, 751 (Bankr. S.D. Ohio 1982) (“since payment of post-petition interest operates to deplete funds which would otherwise be available for subordinate creditors, equitable considerations may be invoked to prevent undue prejudice to junior creditors.”).

¹⁷⁹ See, e.g., 11 U.S.C. §§ 327, 330, 502(b)(4), 523(d) (2019).

¹⁸⁰ Section 504(b)(4) also applies to insiders of the debtor, such as the officers and directors of the debtor, but this is less relevant for our analysis. See *In re Allegheny Int'l*, 158 B.R. 332, 339 (Bankr. W.D. Pa. 1992).

¹⁸¹ See *Butner v. United States*, 440 U.S. 48, 55 (1979).

¹⁸² See *In re W. Real Estate Fund*, 922 F.2d at 597; *In re Staggie*, 255 B.R. 48, 52 (Bankr. D. Idaho 2000).

¹⁸³ See *In re CWS Enter.*, 870 F.3d 1106, 1115 (9th Cir. 2017); *In re K.H. Stephenson Supply Co.*, 768 F.2d 580, 585 (4th Cir. 1985); *In re Hudson Shipbuilders, Inc.*, 794 F.2d 1051, 1056 (5th Cir. 1986); *In re 268 Ltd.*, 789 F.2d 674, 676–77 (9th Cir. 1986).

¹⁸⁴ See, e.g., *In re CWS Enter.*, 870 F.3d at 1115.

this reasonableness standard. In a case where there is a fee-shifting statute or contract that provides for reasonable fees, the court has the ability to adjust an award provided under a contingency fee arrangement so long as the court deems that attorney's fee award unreasonable.¹⁸⁵ Courts generally follow the "lodestar method" when determining the reasonability of attorneys' fees.¹⁸⁶ Under this method, courts calculate a reasonable attorney's fee rate by "multiplying the attorneys' reasonable hourly rate by the number of hours reasonably expended."¹⁸⁷ While the lodestar method is the primary method for calculating attorneys' fees, use of this method is not mandatory in bankruptcy proceedings.¹⁸⁸ Courts therefore have the flexibility to employ any federal formula they see fit.¹⁸⁹ For example, bankruptcy courts in the Ninth Circuit¹⁹⁰ determined the reasonability of attorneys' fees by comparing (1) a claim for attorneys' fees with (2) the total amount likely to be recovered in that case.¹⁹¹ This comparative standard places a duty on the attorney to "scale his or her fees at least to the reasonably expected recovery,"¹⁹² and to stop working on his or her case when the "time spent by counsel is not helpful because it is grossly disproportionate to the amount at stake."¹⁹³ Otherwise, an attorney may not be awarded all of the fees he requests from the court.¹⁹⁴

¹⁸⁵ See, e.g., *Pennaco Energy, Inc. v. Sorenson*, 371 F.3d 120, 131 (Wyo. 2016) (reducing attorneys' fee award to \$311,478.13 from initial contingency agreement where attorney was entitled to 40% of gross recovery after trial (\$422,393.04 in fees on a \$1,055,982.62 judgment)).

¹⁸⁶ See generally *In re Boddy*, 950 F.2d 334, 337 (6th Cir. 1991) (explaining that the lodestar method is the "formula used to calculate fees under various federal fee-shifting statutes").

¹⁸⁷ *Grant v. George Schumann Tire & Battery Co.*, 908 F.2d 874, 879 (11th Cir. 1990); see C.R. Bowles, *What is Reasonable Under Lodestar*, AM. BANKR. INST. (Dec. 1, 2004), <https://www.abi.org/abi-journal/what-is-reasonable-under-lodestar>.

¹⁸⁸ See *In re K.H. Stephenson Supply Co.*, 924 F.2d at 960.

¹⁸⁹ See *First Nat'l Bank & Tr. Co. v. Bassett*, 83 P.2d 837, 840 (Okla. 1938) (seeking compensation on a quantum meruit basis); *In re K.H. Stephenson Supply Co.*, 924 F.2d at 960.

¹⁹⁰ This Ninth Circuit rule presumably defines reasonability standards when applying California's inverse condemnation statute, but as discussed in *supra* Section III.B.1, the laws at the state level do not control the bankruptcy courts.

¹⁹¹ See, e.g., *Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc.*, 924 F.2d 955, 961 (9th Cir. 1991) (using alternative fee formula, where reasonable compensation was one-third of the total recovery); *In re Segovia*, 387 B.R. 773, 782 (Bankr. N.D. Cal. 2008) (finding that \$50,000 was the maximum amount that could be allowed as reasonable, where the likely maximum recovery was \$150,000); *In re DBI Housing, LLC*, 2012 Bankr. LEXIS 2984, at *5 (Bankr. C.D. Cal. June 29, 2012) (disallowing portion of attorneys' fees because the debtor's attorney did not scale its services to the expected recovery).

¹⁹² *In re Segovia*, 387 B.R. at 779.

¹⁹³ *Id.*

¹⁹⁴ See, e.g., *Puget Sound Plywood*, 924 F.2d at 956 (affirming district court's award of attorneys' fees; awarding \$7,172.63 of the \$21,465.00 requested by attorney in his fee application).

When an attorney's fees are paid on a contingency basis, courts sometimes consider making a contingency adjustment to the lodestar calculation.¹⁹⁵ This adjustment provides an additional amount of fees to attorneys working under contingency agreements, on top of the usual lodestar fee amounts. Underlying this adjustment is the theory that an attorney is unlikely to take a high-risk contingency case without the assurance that she will receive a premium on fees if the litigation is successful.¹⁹⁶ Moreover, the party seeking a contingency adjustment bears the burden of justifying the imposition of the additional fee.¹⁹⁷ However, the Supreme Court recognized a "strong presumption" that the lodestar calculation is reasonable on its own, which may only be overcome under "rare circumstances."¹⁹⁸

b. Structure of a Code Amendment

There are two possible ways to achieve this amendment to the Code: (1) by amending section 502(b)(4) to disallow unreasonable claims of attorneys for both debtors and creditors, or (2) by amending section 726 to separate payments on the reasonable and unreasonable portions of claims for all attorney fees. Of these two proposed amendments, this Comment advocates for latter, as its approach allows unreasonable claims for attorneys' fees to be filed—respecting the parties' freedom to contract, even if the tort victim made a bad deal with his attorney—while still affording bankruptcy courts the means to protect an estate from these unreasonable claims if the estate is short on funds.

i. Amending 11 U.S.C. § 502(b)(4)

Under the first proposed amendment to the Code, Congress would re-write section 502(b)(4) to empower bankruptcy courts to disallow *all* unreasonable claims for services of an attorney—including both attorneys for the debtor *and* the creditor. For bankruptcy courts, this amendment would be an efficient change because it would not require judges to apply a new standard. Instead, they would apply the current standard used to evaluate the reasonability of a debtor's attorneys' fees claim.

¹⁹⁵ See *Morgan v. Kingen*, 210 P.3d 995, 1000 (2009). *But see* *City of Burlington v. Dague*, 505 U.S. 557, 567 (1992) (finding against adoption of contingency enhancement for lodestar).

¹⁹⁶ See *Bowers v. Transamerica Title Ins. Co.*, 675 P.2d 193, 204 (1983); *Pennaco Energy, Inc. v. Sorenson*, 371 P.3d 120, 135 (Wyo. 2016) ("a reasonable fee is one that is adequate to induce competent counsel to undertake representation in a meritorious case, but it should not result in a windfall.").

¹⁹⁷ *Morgan*, 210 P.3d at 1000.

¹⁹⁸ *Perdue v. Kenny A.*, 559 U.S. 542, 543 (2010); see *Pennaco Energy, Inc.*, 371 P.3d at 133–35 (describing factors to consider when applying a multiplier).

If adopted, the first amendment would simplify the claim allowance process for all claims for attorneys' fees—whether made by the debtor or a creditor. Beginning with section 502(a), the court would assume that all claims for the services of a creditor or debtor's attorney are permissible. Next, the court would review each of the disallowance provisions of section 502(b). When reviewing the section 502(b)(1) exception, most claims for creditors' attorneys' fees would presumptively be disallowed because they are “unenforceable against the debtor . . . under any agreement or applicable law.”¹⁹⁹ Recall, the American Rule requires individuals to pay their own attorneys' fees.²⁰⁰ However, if an enforceable fee-shifting contract or statute existed, then these claims for attorneys' fees would be enforceable under applicable law, and therefore no longer disallowed under section 502(b)(1).

Subsequently, we would now need to look at the proposed amendment to section 502(b)(4). In this amended version of section 502(b)(4), all debtor and creditor claims for attorneys' fees would be disallowed to the extent that they were unreasonable. The reasonable amounts would remain allowed under section 502(a) because these amounts were not disallowed by any provisions in section 502(b). When handling the allowed reasonable fees under section 506, this amended version of the Code would conform with the current majority approach to a creditor's attorneys' fees. The result would be as follows: over-secured creditors' claims for attorneys' fees would receive elevated secured status; all other allowed unsecured claims would remain unaffected by section 506(b), and their attorneys' fees would remain unsecured.

This amendment diverges from the current Code because claims for unreasonable creditors' attorneys' fees are never disallowed. While a creditor's over-secured claim and the accompanying reasonable attorneys' fees receive elevated secured status, the Code does not address unreasonable fees. While these unreasonable fees did not receive elevated status under section 506, the Code does not disallow such fees because section 502(b) does not prohibit the unreasonable *creditor's* claims for attorneys' fees.²⁰¹ Under the current Code, the over-secured creditor's claim for unreasonable fees still exists in its non-elevated form, and has the same status as all other unsecured claims. As the Code is currently interpreted by the majority of courts, over-secured creditors receive their *unreasonable* fees at the same pro rata amount as unsecured creditors

¹⁹⁹ *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 449 (2007) (citing 11 U.S.C. § 502(b)(1) (2019)).

²⁰⁰ *See id.* at 448; *In re Lane Poultry of Carolina, Inc.*, 63 B.R. 745, 750 (Bankr. M.D.N.C. 1986).

²⁰¹ *See* 11 U.S.C. § 502(b)(4) (2019) (only applies to attorneys of the debtor).

receive even their *reasonable* fees.²⁰² Therefore, this amendment to section 502(b)(4) would resolve this problem by ensuring that attorneys are *never* able to collect on their unreasonable claims.

ii. Amending 11 U.S.C. § 726

A second way to amend the Code would involve leaving section 502(b)(4) unchanged. Because section 502(b)(4) only disallows a portion of a debtor's attorneys' claim, the reasonable and unreasonable amounts of a creditor's attorneys' fees would both remain allowed.²⁰³ After a creditor's attorney made a claim for fees in section 502(a), there would still be no provision in section 502(b) that disallowed any portion of those fees. In accordance with the majority view, these fees—in their reasonable and unreasonable amounts—would remain allowed. Reasonable over-secured claims for attorneys' fees would then be elevated in section 506(b), leaving the same analysis as found in Section II.A.2.b.i. of this Comment.²⁰⁴

The Code would then be amended with respect to section 726, creating a new category for sequential distribution to unsecured creditors. In section 726, all unsecured creditors receive their distributions at a certain level of priority among claims. This second proposed Code amendment would provide a subsequent category for distribution, known as “unreasonable claims for attorneys' fees,” which would include both over-secured and unsecured creditor's remaining attorneys' fees. With this amendment, over-secured creditors would receive their reasonable attorneys' fees first²⁰⁵ and unsecured creditors would receive their reasonable attorneys' fees second.²⁰⁶ The new amendment would allow all remaining unreasonable claims for attorneys' fees to be distributed only if the estate still had resources after all other distributions. Because the commentary on the topic of attorneys' fees often emphasizes the importance of leaving attorneys with the benefit of their bargained-for contract,

²⁰² See *In re 268, Ltd.*, 789 F.2d 674, 678 (9th Cir. 1986). The Western District of Kentucky applied the *In re 268, Ltd.* standard, finding:

Although the balance of the fees sought by the creditor in 268 Limited, were not reasonable and thus were not entitled to a secured status under Section 506(b), . . . they were enforceable under state law and, therefore, could be claimed under Section 502(b)(1) just as any other unsecured claim.

Liberty Nat'l Bank & Tr. Co. v. George, 70 B.R. 312, 317 (W.D. Ky. 1987).

²⁰³ See 11 U.S.C. § 502(b)(4).

²⁰⁴ *Supra* Section II.A.2.b.i.

²⁰⁵ See 11 U.S.C. § 725.

²⁰⁶ See *id.* § 726.

this amendment to the Code balances the freedom to contract with the need to preserve finite resources of the bankruptcy estate.²⁰⁷ Thus, while the current Code makes pro rata distributions to unsecured creditors on their allowed claims all at once, this amendment would ensure that all reasonable attorneys' claims, as well as unsecured tort victim claims, were fulfilled in whole before any money went towards an unreasonable claim for attorneys' fees.

c. Comparing Policy Implications of the Suggested Amendments

When comparing these two approaches to amending the Code, both have important policy implications. Under the first approach—which disallowed all unreasonable fees—the bankruptcy court would be tampering with the parties' freedom to contract. With this approach, there is no way a creditor or debtor's attorney would ever receive the unreasonable portion of their contracted-for fees. Under the second approach, the attorneys could receive the unreasonable portion of their fees, but this would only happen if there was money left in the estate after all pro rata distributions to unsecured creditors. The second approach still interferes with the parties' freedom to contract, but it now balances this right with the bankruptcy court's desire to distribute assets of the estate in the most equitable manner, since an unreasonable claim would be demoted under the second approach. In sum, Congress must acknowledge certain important policy considerations before deciding whether to take either approach to amending the Code. The following section shall discuss policy considerations for the adoption of either proposed amendment.

3. Policy Arguments for a Code Amendment

a. Bankruptcy Courts Are Courts of Equity

The bankruptcy process has two primary goals to balance: (1) providing the debtor with a fresh start from his pre-bankruptcy debts and (2) providing equitable treatment for all creditors. According to the Supreme Court, a bankruptcy court has the complete power to evaluate the validity of claims asserted against the estate “according to the equities of the case.”²⁰⁸ The bankruptcy court can therefore modify the relationship between creditors and

²⁰⁷ See Michael L. Cook, *Court Wrongly Disallows Lender's Post-Bankruptcy Legal Fees*, LAW360 (Dec. 8, 2017, 4:59 PM), <https://www.srz.com/images/content/1/5/v2/154014/Law360-Court-Wrongly-Disallows-Lender-s-Post-Bankruptcy-Legal-Fe.pdf>; *In re United Merch. & Mfrs., Inc.*, 674 F.2d 134, 137 (2d Cir. 1982).

²⁰⁸ See *Pepper v. Litton*, 308 U.S. 295, 304 (1939).

debtors in the name of equity²⁰⁹ and should be given the explicit power to review a creditor's claim for their attorneys' fees to ensure this claim is reasonable.

b. Parties Should Have the Freedom to Contract

On the other hand, parties should be free to govern their own contractual arrangements without the inference of the government.²¹⁰ When parties agree to pay a certain amount of attorneys' fees, the attorney collecting those fees might have declined to provide his services for fees of any lesser amount.²¹¹ Furthermore, if a creditor's attorney knows that bankruptcy courts might alter his contractual rights to attorneys' fees, then the attorney might refuse to take on the creditor's bankruptcy case.²¹² This refusal would hurt creditors because they would struggle to find representation in bankruptcy proceedings.

While there are competing concerns between the bankruptcy court's equitable powers and the parties' freedom to contract, exceptions for creditors' attorneys should not be made in the name of enforcing contracts. Under the current Code, attorneys often agree to represent debtors, even with the understanding that their fee arrangements might be altered by bankruptcy courts. As a result, debtors' attorneys are not discouraged from entering these fee contracts when representing debtors in bankruptcy proceedings. Creditors' attorneys also should not be discouraged, as they are motivated by the same incentive—to get paid—as the debtor's attorneys. Like debtors' attorneys, whose fees are subject to the equitable powers of the bankruptcy court, creditors' attorneys should not receive windfall awards for their unreasonable fees in bankruptcy proceedings. Additionally, the Code already grants bankruptcy judges the equitable power to alter contracted payment amounts for all other attorneys in bankruptcy.²¹³ Thus, Congress' adoption of one of these Code amendments would effectuate a more consistent standard of treatment for attorneys across bankruptcy proceedings, rather than leaving ambiguity regarding the power of judges to adjust fee contracts in cases involving creditors' attorneys' fees.

²⁰⁹ See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988).

²¹⁰ *Hamdan*, *supra* note 121, at 2310.

²¹¹ See *Hamdan*, *supra* note 121, at 2286.

²¹² See *In re United Merchs. & Mfrs., Inc.*, 674 F.2d 134, 137–44 (2d Cir. 1982) (“allowing a claim under a collection costs provision merely effectuates the bargained-for terms of the loan contract [as the appellants] merely seek to reap the benefits of a fairly negotiated bargain.”).

²¹³ See *In re Kroh Bros. Dev. Co.*, 88 B.R. 997, 1004 (Bankr. W.D. Mo. 1988).

c. *The Unexpected Fact Pattern from PG&E Leads to Unjust Results Without This Code Amendment*

If Congress predicted a situation like PG&E where many creditors receive their attorneys' fees from one debtor, Congress would have wanted to avoid this type of result. This result is unjust for three inter-connected reasons. First, an attorney typically enters into a contingency fee arrangement when facing a high risk of nonrecovery that justifies her collection of a higher rate of compensation than she might receive in a case where the risk of nonrecovery is relatively low. Because the PG&E matter is proceeding in the bankruptcy court,²¹⁴ the attorneys involved are not taking on the risk of losing the case in trial and receiving nothing. Moreover, because every client in the PG&E case will receive a payment from PG&E's estate, this payment guarantee also extends to their attorneys. Therefore, while a higher percentage fee may seem reasonable in the context of a risky jury trial, a bankruptcy judge might suspect that lawyers entering into high recovery arrangements with unsophisticated tort claimants are simply taking advantage of the bankruptcy system.

Second, even if an attorney in the PG&E case created an attorney-client relationship with the tort victim before she knew that the PG&E case would be proceeding in the bankruptcy court system, a high contingency fee arrangement would still be inappropriate. More specifically, because the inverse condemnation statute created strict liability for PG&E, the risk of non-recovery in the PG&E case was less than that of usual mass tort cases where attorneys must use contingency fee arrangements to mitigate the risk of nonrecovery. If the PG&E case had proceeded in trial court, and then the attorney and client came to the bankruptcy court to collect on their judgment,²¹⁵ the bankruptcy judge still would have wanted a mechanism to reduce the unreasonable contingency fees of attorneys.²¹⁶

Third, while unreasonable contingency fee arrangements are always harmful when an attorney takes advantage of a client, the impact of the unreasonable fee arrangement in the PG&E bankruptcy case extends beyond this effect. If there was not a fee-shifting statute in this case, all tort victims would receive their pro rata distribution, and then would pay their attorneys outside of bankruptcy based on their private contractual agreements. In the PG&E case, because the bankruptcy court treats attorneys' fees like any other unsecured claim, the

²¹⁴ Avalos, *supra* note 16.

²¹⁵ This could also happen if Judge Montali lifted the automatic stay via 11 U.S.C. § 362 (2019).

²¹⁶ See generally *In re 268, Ltd.*, 85 B.R. 101, 103 (B.A.P. 9th Cir. 1988) ("The Supreme Court in Nevada considered unreasonable attorney fee contracts to be at war with the best interests of society.").

creditors with high contingency fees are taking advantage of the entire estate. Thus, while a debtor's attorney who applied for unreasonable fees would have his claim partially disallowed under section 502(b)(4), a creditor's attorney could gain a windfall recovery of unreasonable fees from the debtor that reduces the pro rata share for all other claimants in their class. Reflecting on the contingency rates in the PG&E case, one expert stated that, "[s]ome attorneys are charging 33 percent, even 40 percent. Personally, I don't see any justification for a contingency fee higher than 20 to 25 percent in this matter."²¹⁷ With one of these amendments to the Code, the bankruptcy court would not need to use valuable assets of the estate to pay such unreasonable claims by creditors' attorneys. These proposed amendments would leave more distributions for unsecured creditors, such as the tort victims, who actually incurred harm from the debtor.²¹⁸

4. *Potential Arguments Against Amending the Code*

There are two potential arguments against amending the Code to disallow unreasonable claims by creditors for their attorneys' fees. First, courts will rarely invoke this amendment because cases involving fee-shifting statutes, like PG&E, are uncommon in the context of bankruptcy proceedings.²¹⁹ However, this argument is not compelling because Congress should not leave gaps in a statute simply because an issue does not arise often. Second, this amendment may actually hurt the tort victim creditors, who could potentially be liable to their attorneys for any unpaid fees in bankruptcy proceedings. But this argument fails because tort victims would not be liable for the unreasonable portion of their attorneys' fees outside of bankruptcy.²²⁰

a. *These Code Amendments Would Not Affect Most Bankruptcy Cases, But Would Have a Meaningful Impact on Future Cases with Fee-Shifting Statute Like PG&E*

While Congress should amend the Code to disallow unreasonable claims for a creditor's attorneys' fees, in most bankruptcy cases this change is unlikely to significantly increase unsecured creditors' distributions on their claims. First,

²¹⁷ Helen Sedwick, *FAQs about PG&E Bankruptcy*, KENWOOD PRESS (May 15, 2019) <https://www.kenwoodpress.com/pub/a/10609?full=1>.

²¹⁸ See *In re 268, Ltd.*, 789 F.2d at 678.

²¹⁹ See Berman & Gilhuly, *supra* note 78, at 32.

²²⁰ See 11 U.S.C. § 524(a)(2) (2019) (explaining that the discharge of the debtor's debts does not extinguish the debts owed by the debtor; it merely protects the debtor from personal liability on these discharged debts. The debt can still be enforced against third party obligors).

unsecured creditors generally pay their own attorneys' fees in bankruptcy cases because of the American Rule.²²¹ Because a tort victim will rarely have a pre-bankruptcy contract with the debtor, these unsecured creditors can only submit a claim for their attorneys' fees in the rare situation where a fee-shifting statute applies.²²² Second, in bankruptcy proceedings, unsecured creditors are not paid in accordance with what they are owed, but instead receive distributions based on much the debtor can afford to pay them.²²³ Unsecured creditors "rarely receive more than pennies on the dollar on account of their unsecured claims."²²⁴ While this amendment "may result in some reallocation of the limited funds available to pay unsecured claims [because certain attorneys would receive a smaller portion of funds], . . . in most cases, it is unlikely to significantly increase the amount that unsecured creditors are paid on account of their claims."²²⁵ The unreasonable portion of attorneys' fees would now be available for distribution to the other unsecured members of the class. But, because there are so many unsecured claimants seeking distributions from the bankruptcy court, the increase in the pro rata payout that each individual claimant receives may not be very large. Because these pro rata amounts for individual claimants generally will not increase dramatically, one could argue that it is not worth the hassle to amend the Code. However, this argument does not stand true for the PG&E case because experts predict that the wildfire victims will recover on a high percentage of the claims that they submitted.²²⁶ In addition, when PG&E last filed for bankruptcy, the estate paid all claims in full.²²⁷ Therefore, this amendment could have a meaningful effect on these victims' recovery in rare situations like this PG&E bankruptcy case.²²⁸

b. Tort Victim Creditors Might Appear To Be on the Hook for Unpaid Attorneys' Fees Outside of Bankruptcy, But That is Incorrect

If the debtor is not required to pay the full amount of a creditor's contractual attorneys' fees, the creditor might remain obligated to pay these fees. While a debtor receives a discharge for personal liability on any unpaid debts after exiting bankruptcy, her third-party co-debtors retain personal liability for these

²²¹ See *Travelers Cas. & Sur. Co. of Am. v. PG&E*, 549 U.S. 443, 448 (2007).

²²² See Berman & Gillhuly, *supra* note 78, at 32.

²²³ 11 U.S.C. § 726(b) (2019); William Hallam, *Fourth Circuit Allows Unsecured Creditors to Assert Claims for Attorneys' Fees in Bankruptcy Cases*, JD SUPRA (Feb. 13, 2019), <https://www.jdsupra.com/legalnews/fourth-circuit-allows-unsecured-79216/>.

²²⁴ Hallam, *supra* note 223.

²²⁵ Hallam, *supra* note 223.

²²⁶ See Sedwick, *supra* note 217.

²²⁷ Sedwick, *supra* note 217.

²²⁸ See Sedwick, *supra* note 217.

debts because these third parties did not receive the debtor's discharge in bankruptcy.²²⁹ This logic extends to the creditor's situation. Specifically, while the debtor must pay the reasonable attorneys' fees for a creditor's claim, the creditor would remain contractually bound for any unreasonable fees under their agreement with the attorney. Creditors who can shift their reasonable attorneys' fees through section 506(b) still bear any costs of "over-lawyering" if they "[fail] to exercise restraint in the attorneys' fees and expenses they incur" in the litigation.²³⁰ If a court finds that a creditor's attorneys' fees seem excessive, the unreasonable portion of these fees would generally be borne by the creditor instead of the debtor.²³¹

Fortunately, because the attorneys of tort victims generally use contingency fee agreements to collect payment for their legal services, the tort victims in PG&E will not remain liable for these fees. This conclusion is apparent for two reasons. First, attorneys bear the risk of non-payment for their services when working under a contingency agreement.²³² Forcing a creditor to assume liability for any unreasonable attorneys' fees would be at odds with this allocation of risk.²³³ Second, the attorney acts as a fiduciary for the creditor, which requires that attorney to act "primarily, if not exclusively for their client's interests. . . ." ²³⁴ When a bankruptcy judge finds that an attorney's contingency fee was unreasonable, it deems that the attorney breached his fiduciary duty by asking his client for an award that is disproportionate to that client's potential recovery.²³⁵ Fiduciary law commands that this contingency fee contract is therefore unenforceable, because its terms were unfair to the client.²³⁶ The laws of equity and fairness supersede contract law in this situation. Therefore, under either of the proposed Code amendments, the creditor would not be required to pay any remaining, unreasonable portion of his claim for attorneys' fees that were not covered by the debtor.

²²⁹ See 11 U.S.C. § 524(a)(2) (2019) (noting that discharge "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the *debtor*, whether or not discharge of debt is waived") (emphasis added).

²³⁰ *In re Staggie*, 255 B.R. 48, 54 (Bankr. D. Idaho 2000).

²³¹ See *In re Ward*, 190 B.R. 242, 251 (Bankr. D. Md. 1995) ("Although these charges are not necessarily wrong or improper, such expense is more properly directed toward the creditor instead of the debtor.").

²³² See *City of Burlington v. Dague*, 505 U.S. 557, 561 (1992).

²³³ See Genet, *supra* note 13 (responding to the Ninth Circuit upholding of a decision to limit an attorney's fees to their reasonable value by warning readers about the "material financial hazard for . . . [a]ttorneys who routinely handle contingency fee matters").

²³⁴ Lester Brickman, *Contingent Fees Without Contingencies: Hamlet Without the Prince of Denmark*, 37 UCLA L. REV. 29, 46-47 (1989).

²³⁵ See *id.* at 51.

²³⁶ See *id.*

CONCLUSION

Bankruptcy judges should have the ability to cap the fees of all attorneys in bankruptcy, including creditors' claims for their attorneys' fees. Congress should therefore amend the Code to provide that judges have the power to alter these creditors' claims for attorneys' fees. This amendment could be accomplished in one of two ways. First, Congress could amend section 502(b)(4). While section 502(b)(4) currently provides that claims for services of a debtor's attorney will be disallowed to the extent they are unreasonable, this amendment would provide that claims for services of an attorney of the debtor *or creditor* must be reasonable. Second, Congress could amend section 726, creating a new category for pro rata distribution for unreasonable claims. With this second amendment, creditors with unreasonable claims could not collect on these claims until all other unsecured claims are paid. This second amendment would allow the bankruptcy court to remain a court of equity, while still accommodating for parties' freedom to contract.

Both of these amendments would provide a substantive change to the Code by giving judges the explicit power to restrict all attorneys' claims for fees to their reasonable value. These amendments would also clarify the jurisdictional split that currently exists when interpreting the Code. Only a minority of courts argue that section 506 disallows all unsecured creditors' claims for their attorneys' fees, and this view is inconsistent with all other Code provisions. The issue is still live, however, in federal courts and therefore should be clarified by Congress. With these proposed amendments, there would be explicit language in the Code discussing creditor's claims for attorneys' fees. These amendments to the Code would clarify the current jurisdictional split by reaffirming, in line with the majority view, that the Code has never disallowed a creditor's claims for attorneys' fees.

While the issue of the debtor's payment of unsecured creditors' attorneys' fees rarely comes up in bankruptcy, it can have a significant impact on the recovery of all unsecured creditors in cases like PG&E. Unsecured creditors will often only recover the bare minimum of what they are owed in bankruptcy. Therefore, from a policy perspective, it is important to maximize the unsecured creditors' recovery by minimizing wasteful payouts. By definition, an "unreasonable" payment to any claimant is a wasteful payout. Congress has already provided judges with the power to restrict unreasonable claims by every attorney in bankruptcy, other than creditors' attorneys. These creditors' attorneys should be no different than other attorneys and should be limited to collecting on the reasonable value of a claim for their fees. If the PG&E lawsuit

proceeded in a trial court, the inverse condemnation statute would have limited these claims for attorneys' fees to their reasonable value. These creditors' attorneys should not be able to receive additional unreasonable recovery simply because the bankruptcy judges do not have the analogous power to limit these fee claims. Unsecured creditors in bankruptcy are already limited in what they can collect, since there are limited funds available for distribution in the debtor's estate, and unsecured creditors are one of the last creditors to be paid in bankruptcy. Therefore, to prevent creditors' attorneys from collecting a windfall recovery at the expense of all other unsecured creditors, Congress should amend the Code to provide judges with the power to disallow *all* unreasonable claims for attorneys' fees.

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