No. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

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

REPLY BRIEF FOR PETITIONER

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QUESTION PRESENTED

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

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SUMMARY OF REPLY

Like the district and bankruptcy courts, the court of appeals resolved Travelers' claim for attorneys' fees exclusively on the basis of its *Fobian* rule: "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)). As demonstrated in Travelers' opening brief, the *Fobian* rule is wrong and, because the decision below is premised exclusively on *Fobian*, it must be reversed.

In each court below, PG&E argued that the *Fobian* rule disposed of Travelers' claim, and PG&E defended *Fobian*. Now, PG&E abandons *Fobian* and invites the Court to adopt a far different rule -- one that it did not raise below, that no court of appeals has ever endorsed, and that lies outside the question presented. Whereas the *Fobian* rule denies claims for attorneys' fees incurred in litigating *federal* issues as a matter of general federal common law, PG&E theorizes that, on the basis of its novel interpretation of the Bankruptcy Code, *all* unsecured claims for attorneys' fees must be denied. Not only is PG&E's theory different from the *Fobian* rule, it is at war with the rule, as PG&E's theory would deny claims for attorneys' fees that *Fobian* permits (i.e., those incurred in litigating state law issues).

Time and again, this Court has stated that it will decline to consider issues not raised or decided below, or that lie outside the question presented, and the Court should apply that prohibition here. Although PG&E's argument is meritless, demonstrating its flaws requires consideration of many arcane bankruptcy concepts. Although Travelers will explain why PG&E's argument is unsound, a full explication is beyond the capacity of a twenty-page reply brief.

In the alternative, PG&E invites the Court to create yet another rule of general federal common law to deny Travelers' claim -- that all claims for attorneys' fees in bankruptcy must be superintended by a heretofore undefined

federal test of reasonableness that Travelers somehow fails. The Court should decline to address PG&E's contention because it was not decided below and is outside the question presented. Moreover, PG&E's contention is meritless -- the standard that PG&E advances is precluded by the text of the Code, and Travelers' conduct was reasonable.

Finally, PG&E argues through selective quotation that Travelers' claim falls outside the scope of its contract. Once again, the Court should decline to address PG&E's contention because it was not decided below and is outside the question presented. In addition, PG&E's argument is meritless -- the indemnity provisions are intentionally broad and encompass any loss associated with the Bond, including Travelers' claim for attorneys' fees.

REPLY TO PG&E'S STATEMENT

PG&E contends that Travelers intervened needlessly in PG&E's bankruptcy proceeding on the theory that Travelers need have done nothing to protect its rights incident to its $100 million Bond. Not so. The whole point of a bankruptcy filing is to impair rights. *Ashton v. Cameron County Water Improvement Dist.*, 298 U.S. 513, 530 (1936) ("The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned -- to change, modify, or impair the obligations of their contracts."). Moreover, the clear rule in chapter 11 is that a party loses its rights if it does not assert them by (1) filing a proof of claim, (2) defending litigation brought by the debtor, and (3) ensuring its proper treatment in a chapter 11 plan.

For example, if Travelers had not filed its proof of claim, PG&E would have been free to default on its workers' compensation obligations, Travelers would have been forced to pay benefits under its Bond, and Travelers would have been unable to recover *anything* in reimbursement from PG&E because its reimbursement claim would have been barred by the failure to file a proof of claim. FED. R. BANKR. P. 3002(a), 3003(b), (c)(2); *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933); *Employee Ret. Corp. v. Osborne (In re*

THC Fin. Corp.), 686 F.2d 799, 802, 804 (9th Cir. 1982) (creditor who failed to file proof of contingent claim barred from recovery). Debtors in bankruptcy frequently default on their bonded obligations (indeed, that is the norm) and, as a result, sureties file proofs of claim at the beginning of a case (when they are required to do so) to protect their interests. *See Aetna Cas. & Sur. Co. v. Clerk of U.S. Bankr. Court (In re Chateaugay Corp.)*, 89 F.3d 942, 945-46 (2d Cir. 1996).

Likewise, if PG&E's Plan had not properly spelled out (at Travelers' insistence) the treatment of the claims of the injured workers, PG&E's obligations to the workers would have been discharged, destroying both the workers' rights to payment and the value of Travelers' subrogation rights -- Travelers' subrogation rights would be worthless if the workers themselves had no rights against PG&E owing to the discharge of their claims. 11 U.S.C. § 1141(d) (discharging all claims except those that are preserved in confirmed plan of reorganization). Further, if Travelers had done nothing to defend the litigation that PG&E commenced seeking to eliminate both Travelers' rights *and* the claims of the injured workers, PG&E would have been entitled to a default judgment securing this relief. FED. R. BANKR. P. 7055 (authorizing bankruptcy court to enter default judgments).

Moreover, Travelers never agreed that its proof of claim or other conduct was improper. Nor did any of the courts below conclude that Travelers acted unreasonably. The bankruptcy court -- the only trier of fact -- expressly ruled: "I don't need to get to the question, and I won't address the question, of whether the fees were reasonable in whole or in part." Pet. App. 25a. Nor did the bankruptcy court otherwise make *any* finding that Travelers need not have (1) filed a proof of claim, (2) objected to PG&E's plan and disclosure statement, (3) defended the litigation that PG&E commenced, or (4) taken any of the other steps that it took. On the contrary, the court stated: "As far as . . . Travelers protecting its position by negotiating with the plan and the disclosure statement, of course, you had every right to do that. . . . I just

don't think the Debtor has to pay for it, because I think it's bankruptcy law." Pet. App. 24a. PG&E never appealed the bankruptcy court's findings, and they remain undisturbed.

Further, Travelers was ultimately successful in protecting both its own rights and the rights of the injured workers. Specifically, at Travelers' insistence, the rights of the injured workers were properly classified and rendered unimpaired under PG&E's plan, and the parties eventually stipulated that Travelers' rights were preserved. For example, the Stipulation provides: "To the extent that Travelers is subrogated to the claim of any obligee under any of its Surety Bonds, Travelers shall hold such claim as a general unsecured creditor . . . ." J.A. at 108a.

PG&E describes as merely "comfort" provisions the portions of PG&E's Plan spelling out the specific treatment of Travelers' rights and the claims of the injured workers. PG&E's characterization is wrong. The provisions in the Plan *define* the rights of the parties, 11 U.S.C. § 1141(a) (the provisions of a confirmed plan bind all parties), and are items that the Bankruptcy Code itself specifically requires, 11 U.S.C. § 1123(a) (a plan "shall" specify the treatment of claims and designate whether they are impaired or unimpaired). Accordingly, PG&E's Plan was defective without them. *See* 11 U.S.C. § 1129(a)(1) (a plan cannot be confirmed if it does not comply with the Bankruptcy Code, including section 1123). Not surprisingly, the bankruptcy court directed that the provisions be included. J.A. at 45a.

PG&E asserts that the rights of the injured workers were never at risk, and cites a provision of its Plan dealing with benefit programs as "executory" contracts. J.A. 28a. But as PG&E well knows, the claims of the injured workers do not qualify as executory contracts, *see* 11 U.S.C. §§ 365 & 1123(b)(2); *In re Texscan Corp.*, 976 F.2d 1269, 1272 (9th Cir. 1992) ("[I]n executory contracts the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other.") (marks and

citations omitted); *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 677 (9th Cir. 1996) ("§ 365 only allows the assumption and assignment of executory contracts"), and the provision of the Plan that PG&E cites refers to its ongoing agreements with third party benefit *administrators*, not the claims of the injured workers themselves (who had no obligations to perform to obtain their benefits). Moreover, PG&E's argument is fundamentally inconsistent with its conduct -- even though it *now* claims that the rights of the workers were never at risk, it previously sought to disallow them. J.A. 76a-80a.

PG&E suggests that it did not unilaterally modify the Negotiated Language preserving Travelers' subrogation rights. Not true. PG&E's red-lined version of its Plan clearly shows the changes that PG&E unilaterally made to the Negotiated Language. The Negotiated Language provided: "The subrogation rights of any surety, to the extent applicable or available, shall be unaffected by the Plan and, if available or applicable, remain in full force and effect." PG&E unilaterally changed this to "[n]othing in the Plan shall (a) affect the subrogation rights of any surety, to the extent applicable or available, which, if available or applicable, shall remain in full force and effect; or (b) the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of such subrogation rights." J.A. at 56a. PG&E then commenced litigation against Travelers by filing its objection and asking for affirmative relief. *See* FED. R. BANKR. P. 3007, 7001. Among other things, PG&E improperly characterized Travelers' subrogation rights as "claims," sought to eliminate them as "not valid," and attempted to "subordinate" Travelers' "claims." J.A. at 73a-74a, 80a. As noted, PG&E also sought to eliminate the claims of the injured workers. J.A. at 76a-80a. Not surprisingly, Travelers responded.

The record demonstrates that Travelers acted prudently to protect its rights (as well as those of the injured employees), and that it was *PG&E* that crafted a defective Plan and

pursued litigation needlessly against Travelers. As PG&E concedes, Travelers' proof of claim "did not assert that PG&E owed Travelers any money" for paying any benefits under its Bond. Resp. Br. at 3. As PG&E also concedes, Travelers merely asserted in its proof of claim that it had certain rights to payment against PG&E in the event it must ever make payment under its Bond, and that all that Travelers was attempting to do was protect its rights. *Id*. Given that Travelers was not seeking to collect money that PG&E did not owe, but was simply seeking to protect its rights, *it is PG&E, not Travelers, that need have done nothing*. PG&E never explains why it commenced litigation objecting to Travelers' rights and seeking to eliminate the claims of the injured workers. The answer is simple: like debtors generally in bankruptcy, PG&E objected to virtually *every* claim because it hoped to reduce its liabilities. Like other creditors, Travelers responded to protect its rights.

Finally, there is nothing mysterious (or nefarious) about the fact that Travelers may recover its attorneys' fees from PG&E incurred in protecting its rights even though Travelers has not paid anything on its Bond. Sureties routinely incur attorneys' fees in setting up and administering complex bond programs for corporations such as PG&E, and corporations such as PG&E are routinely responsible for paying the surety's attorneys' fees even though the surety has not made (and may never have to make) any payment under its bonds. That is the nature of the parties' bargain, and PG&E cannot claim successfully that it is at all unusual or contrary to legitimate commercial practice.

ARGUMENT

A. PG&E's Novel Interpretation Of The Bankruptcy Code Is Unsuitable For Review and Without Merit.

In its opening brief, Travelers demonstrated that it holds a "claim" for its attorneys' fees. Travelers also demonstrated that its claim for attorneys' fees should have been allowed under section 502. Section 502(b) directs that a claim must be allowed, unless one of the enumerated grounds for

disallowance applies. Because none of the grounds for disallowance applies, section 502 requires allowance.

The courts below denied Travelers' claim for one reason only -- the *Fobian* rule. In its opening brief, Travelers demonstrated that the *Fobian* rule is unsound. Critically, PG&E does not disagree. Because the *Fobian* rule is invalid, this Court should reverse and decline to address PG&E's alternative theory.

1. The Court Should Not Consider PG&E's Theory.

Abandoning *Fobian*, PG&E contends that, on the basis of its novel interpretation of the Bankruptcy Code, *all* unsecured claims for attorneys' fees based on pre-petition contractual or statutory entitlements must be denied, regardless of whether the fees were incurred in litigating state or federal issues. PG&E failed to raise this theory below or in its opposition to Travelers' petition for certiorari. Further, PG&E's theory lies outside the question presented, which involves exclusively the legitimacy of the *Fobian* rule.

The Court has stated repeatedly that it "is a court of review, and it will not consider questions not raised or disclosed by the record brought to it for a review and which were not considered by the courts below." *Edward Hines Yellow Pine Trustees v. Martin*, 268 U.S. 458, 465 (1925); *see also Clingman v. Beaver*, 544 U.S. 581, 597-98 (2005); *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 168-69 (2004). In addition, "we continue to strongly 'disapprove the practice of smuggling additional questions into a case after we grant certiorari.'" *Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510 U.S. 27, 34 (1993) (citation omitted); *see also* SUP. CT. R. 14.1(a) ("Only the questions set out in the petition, or fairly included therein, will be considered by the Court."); *Glover v. United States*, 531 U.S. 198, 205 (2001); *Roberts v. Galen of Virginia, Inc.*, 525 U.S. 249, 253-54 (1999).

Given Rule 14.1(a) and the Court's often-repeated admonitions, it was entirely inappropriate for PG&E and its *amici* to raise their novel theory for the first time in their

briefs on the merits (and devote almost their entire eighty pages of briefing to it), subject only to a twenty-page reply from Travelers. PG&E's tactic is particularly burdensome because no court of appeals has ever endorsed PG&E's theory, and there has been no development of the theory through meaningful appellate review. Further, review of the theory necessarily involves consideration of numerous arcane provisions of the Bankruptcy Code not implicated by the question presented. Nor does PG&E present any persuasive reason for being excused from failing to raise its theory earlier. Travelers challenged the legitimacy of the *Fobian* rule in each court below (as well as in its petition for certiorari), and PG&E had ample opportunity to raise its theory, but chose not to. PG&E should not be permitted to burden the Court with what amounts to litigation by ambush.

2. PG&E's Argument Is Contrary To The Code, and Foreclosed Because PG&E Is Solvent.

PG&E's novel argument is also without merit. Although PG&E sometimes characterizes Travelers' right to payment of its attorneys' fees as a post-petition "administrative expense" rather than a "claim," Resp. Br. at 27, PG&E concedes that the definition of claim "appears" to include a pre-petition contractual right to attorneys' fees, even though the fees are incurred after the debtor files for bankruptcy. Resp. Br. at 15. From there, however, PG&E abandons what the Code actually says in favor of a speculative guessing game about what Congress might have thought about pre-petition contractual rights to attorneys' fees that are not yet incurred at the time the debtor files for bankruptcy. PG&E's speculation is foreclosed by what Congress actually drafted, and likewise by the fact that PG&E is a solvent debtor.

First, PG&E confuses the difference between "claims" and "administrative expenses," and what rights to payment properly constitute "claims." In determining whether Travelers' holds a claim, it does not matter that Travelers incurred its attorneys' fees post-petition after PG&E filed for bankruptcy. What matters is that Travelers' right to payment

arises from its pre-petition contract because the definition of "claim" specifically includes a right to payment that is "contingent," "unmatured," or "unliquidated" at the time the debtor files for bankruptcy. *See In re Bayly Corp.*, 163 F.3d 1205, 1208-09 (10th Cir. 1998) ("If a debtor becomes liable to a claimant before the bankruptcy petition is filed, but the liability is contingent on the occurrence of some future event, the claim to recover that debt is treated as a pre-petition claim even if the condition does not occur and the right to payment does not arise until after the bankruptcy petition is filed."); *In re Fostvedt*, 823 F.2d 305, 306-07 (9th Cir. 1987).

At the time PG&E filed for bankruptcy, Travelers held a contractual right to payment of its attorneys' fees, but had not yet incurred the fees. Travelers incurred the fees after PG&E filed for bankruptcy, and PG&E's liability became "fixed" when the fees were incurred. But PG&E's liability still arises from its pre-petition contract -- there is no other basis for the liability. Accordingly, Travelers' right to payment is properly a "claim" within the meaning of section 101(5). *In re Kadjevich*, 220 F.3d 1016, 1020 (9th Cir. 2000) (post-petition attorneys' fees on pre-petition obligation held to be general unsecured claim); 5 COLLIER ON BANKRUPTCY ¶ 553.03[1][i] at 553-20 - 21 (15th ed. rev. 2004) ("In general, if the creditor incurs the attorneys' fees postpetition in connection with exercising or protecting a prepetition claim that included a right to recover attorneys' fees, the fees will be prepetition in nature, constituting a contingent prepetition obligation that became fixed postpetition when the fees were incurred.").

It cannot be otherwise. If obligations arising from pre-petition contracts that become fixed after the debtor files for bankruptcy were not "claims," then they would not be cognizable (or dischargeable) in bankruptcy at all. *See Ohio v. Kovacs*, 469 U.S. 274, 286 (1985) (O'Connor, J., concurring) (making this observation). They would not be administrative expenses. Administrative expenses are post-petition obligations of the *bankruptcy estate* under section

503 of the Bankruptcy Code, such as obligations arising from purely post-petition contracts or services provided to the estate. 11 U.S.C. § 503; *In re Kadjevich*, 220 F.3d at 1019-20 (discussing administrative expenses); *In re Abercrombie*, 139 F.3d 755, 756-78 (9th Cir. 1998) (same). Travelers' right to payment of its fees is squarely a "claim."[1]

Second, PG&E's theory attempts to engraft onto section 502 restrictions that Congress has rejected. Congress chose to exclude from the concept of an "allowed claim" only one type of right to payment of attorneys' fees -- those of the debtor's attorney, and only to the extent that the fees exceed the reasonable value of the attorneys' services (e.g., a contingency fee arising from pre-petition services fixed by a

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[1] For example, suppose PG&E guaranteed a $100 million debt that its corporate parent ("Parent") owed to a bank ("Bank"). Suppose that, at the time PG&E filed for bankruptcy, the Parent had not yet defaulted on the $100 million obligation to the Bank and, thus, PG&E owed nothing on its guaranty at that time. Nevertheless, the Bank would hold a "claim" against PG&E on the guaranty even though PG&E's liability at the time of its bankruptcy filing was "contingent" upon the Parent's future default. Suppose further that, after PG&E filed for bankruptcy, the Parent then defaulted on the $100 million obligation. PG&E's liability would no longer be "contingent;" it would be "fixed" by the Parent's default. PG&E's guaranty liability, however, would still constitute a claim even though it became "fixed" post-petition. *See In re All Media Properties, Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980) (discussing the "classic contingent liability of a guarantor [of a note where] both the creditor and guarantor knew there would be liability only if the principal maker defaulted."), *aff'd*, 646 F.2d 193 (5th Cir. 1981). If amounts arising from pre-petition contracts that become fixed after a debtor files for bankruptcy were not claims, a debtor with contingent guaranty obligations could file for bankruptcy and pay nothing on its guaranty obligations simply by virtue of the fact that they had not yet become fixed. The law prescribes otherwise.

post-petition judgment). 11 U.S.C. § 502(b)(4). Had Congress intended to exclude any other right to payment of attorneys' fees from an allowed unsecured claim, Congress would have done so in section 502. For example, by analogy, Congress expressly excluded from an allowed unsecured claim any pre-petition contractual right to *interest* incurred post-petition. 11 U.S.C. § 502(b)(2); *United Sav. Assoc. of Texas v. Timbers of Inwood Forest*, 484 U.S. 365, 372-73 (1988) (section 502(b)(2) is the "general rule disallowing postpetition interest"). Congress chose not to do the same for post-petition *attorneys' fees*, and the courts should not engraft onto the text what Congress omitted. That is especially so because Congress considered *and rejected* what PG&E wishes to add to the text. *See* S. 1301, 165th Cong., § 203 (June 4, 1998) (failed amendment that "a creditor may not charge a debtor, or the account of a debtor, for attorneys' fees or costs for work performed in connection with a case brought under this title.").

Third, although PG&E classifies Travelers' claim for its attorneys' fees as a "contingent" claim, it concedes that the contingent nature of a claim is not grounds for disallowance. 11 U.S.C. § 502(b)(1). Indeed, regardless of whether Travelers' claim for its fees is classified as "contingent," "unliquidated," or "unmatured," *none* of these characteristics are, by themselves, grounds for disallowance.

Fourth, the fact that section 502 provides that the court shall determine a claim "as of the date of the filing of the petition" does not render section 502 ambiguous or somehow preclude the allowance of Travelers' claim. The phrase "as of the date of the petition" simply marks the boundary between pre-petition "claims" and post-petition expenses of administration. The boundary is significant because, generally speaking, administrative expenses are entitled to priority over claims. *See* 11 U.S.C. § 507(a)(2).

Fifth, PG&E's reference to the estimation procedures of section 502(c) is equally unavailing. Section 502(c) simply provides that "[t]here shall be estimated for purpose of

allowance under this section . . . any contingent or unliquidated claim, the fixing or liquidation of which would unduly delay the administration of the case." 11 U.S.C. § 502(c). The key phrase is "unduly delay." To the extent that a claim for fees can be determined during the course of the debtor's bankruptcy case -- for example, the relevant fees are incurred in litigating issues during the course of the case -- the claim should be allowed in the amount incurred. To the extent that the claim for fees cannot be determined during the course of the case -- for example, the fees will continue to be incurred after the debtor's bankruptcy case is over -- the fees should be estimated and allowed in the estimated amount. Section 502(c) is simply an administrative mechanism to facilitate the closing of bankruptcy cases.

Sixth, PG&E misconstrues section 506. By its terms, section 506 (captioned "Determination of secured status") prescribes only when a particular right to payment is given *secured* status and, therefore, afforded priority over unsecured claims and administrative expenses. *See* 11 U.S.C. §§ 725, 1129(b)(2); *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 238-39 (1989) ("Section 506 . . . governs the definition and treatment of secured claims."). But Travelers does not contend that its claim is secured; it contends that its claim is *un*secured. Accordingly, section 506 does not apply. Moreover, reference to section 506 in context with section 502 only confirms that there is no basis in *either* section for disallowing Travelers' right to payment of its attorneys' fees as an unsecured claim.

The mechanics of section 506 are straightforward. To begin with, section 506(a) provides that a claim that is secured by a lien on property of the bankruptcy estate is a "secured" claim to the extent of the *value* of the property securing the claim. In other words, section 506(a) gives a claim secured status to the extent of the value of the collateral. The balance of the claim not covered by the value of the collateral (the "deficiency") is treated as an unsecured claim. *Ron Pair*, 489 U.S. at 239 ("Subsection (a) of § 506

provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured.").

Next, section 506(b) prioritizes the elements of the secured claim by adding post-petition interest and attorneys' fees to the pre-petition amount of the claim to the extent that the value of the collateral is sufficient to cover *both* the pre-petition amount and the post-petition interest and fees -- in bankruptcy parlance, the claim is "over-secured." *Ron Pair*, 489 U.S. at 239 ("Subsection (b) is concerned specifically with oversecured claims, that is, any claim that is for an amount less than the value of the property securing it. . . . Section 506(b) allows a holder of an oversecured claim to recover, in addition to the prepetition amount of the claim [post-petition interest and attorneys' fees]").

Critically, section 506(b) does not say *anything* about whether post-petition interest or attorneys' fees may constitute an *un*secured claim under section 502. This is not surprising because that is the province of section 502. Moreover, construing section 506(b) to disallow post-petition interest or attorneys' fees from an unsecured claim would render superfluous critical provisions of section 502.

For example, as noted, section 502(b)(2) disallows from an *un*secured claim any post-petition *interest*. The fact that section 506(b) permits *adding* post-petition interest to an over-secured claim cannot be construed to mean that, by implication, section 506(b) *subtracts* post-petition interest from an *un*secured claim because doing so would render superfluous section 502(b)(2).

Further, the reason why section 506(b) prioritizes the elements of a secured claim is straightforward. Section 506(b) incorporates the pre-petition amount *first* to prevent lenders from front-loading their secured claims with post-petition interest. As noted, any amount of a claim not covered by the value of the collateral securing it is treated as an unsecured "deficiency" claim. If secured lenders could front-load their post-petition interest in their secured claims,

they could allocate pre-petition amounts to their unsecured deficiency claims to avoid section 502(b)(2). *See Sexton v. Dreyfuss*, 219 U.S. 339 (1911).

PG&E contends that its reading of section 506(b) as a general disallowance provision applicable to unsecured claims is confirmed by *Timbers*. Not so. In *Timbers*, the Court noted the interplay between sections 506(b) and 502(b)(2). 484 U.S. at 365. Critically, the Court explained that a creditor who is not entitled to post-petition interest as part of its secured claim is denied its claim for post-petition interest as part of its *un*secured claim *not* by section 506(b), *but by section 502(b)(2)*. *Id*., at 372-73. This establishes that section 506(b) does not disallow post-petition interest from unsecured claims. *A fortiori*, section 506(b) does not disallow attorneys' fees from unsecured claims either.

Congress knew all about pre-petition contractual rights to post-petition attorneys' fees when it drafted the Code (e.g., section 506(b)). Congress also knew that pre- and post-petition attorneys' fees would be allowed as part of a creditor's unsecured claim under section 502 (e.g., section 502(b)(4)). Had Congress intended to disallow all post-petition *attorneys' fees* from an allowed *un*secured claim, Congress would have added such a prohibition in section 502 just as it did for post-petition *interest*.

PG&E contends that section 506 is a blanket disallowance provision applicable to both secured and unsecured claims because, if Congress adds some item to secured claims under section 506, it must, *a fortiori*, intend the obverse -- to deny the same item to unsecured claims under section 502. Resp. Br. at 18. Critically, PG&E's theory -- that an "allowed claim" cannot include any interest or attorneys' fees because these are added to an allowed secured claim by section 506(b) -- cannot be right because it would also require the disallowance of *pre*-petition interest and attorneys' fees from unsecured claims (section 506(b) does not specify that it applies only to "post-petition" interest and attorneys' fees) -- a result at war with over a century of

established bankruptcy law, including *Cohen v. De La Cruz*, 523 U.S. 213, 223 (1998) and *Ron Pair*. *See also Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163-64 (1946) (prohibition on interest applies to post-petition interest, and explaining practice that section 506(b) codifies).

PG&E counters that reading section 502 to allow post-petition attorneys' fees as part of an unsecured claim would render section 506(b) superfluous on the theory that, if pre-petition contractual rights to post-petition attorneys' fees may be part of a creditor's allowed claim under section 502, then they would already be included as part of a secured claim under section 506(a). Resp. Br. at 18, 24-25. Not so. As noted, section 506(b) *prioritizes* the elements of a secured claim, providing that that post-petition interest and attorneys' fees are to be treated as secured only if there is already enough value in the collateral to cover the pre-petition amount of the claim. *Ron Pair*, 489 U.S. at 238-40.

PG&E insists that Congress's use of the phrase "such claim" in section 506(b) refers to the underlying "allowed claim," therefore demonstrating that post-petition attorneys' fees cannot be included as part of a creditor's unsecured allowed claim because then they would already be part of a secured creditor's claim without section 506(b). But the Court has already resolved this interpretive issue by concluding that "'[s]uch claim' refers to an oversecured claim" just as Travelers has described it. *Ron Pair*, 489 U.S. at 241. As the Court's clarification reveals, the text and context of sections 506(a) and (b) demonstrate their operation with sufficient certainty to avoid ambiguity.

PG&E contends that claims for attorneys' fees should not be included as allowed claims within the scope of section 502 because section 502 does not specifically mention claims for attorneys' fees, whereas section 506(b) does. Resp. Br. at 18-19. PG&E, however, overlooks section 502(b)(4) (addressing attorneys' fees), and likewise mistakes the operational differences between the section 502 and 506(b). Section 502 deals with claims generally, and directs that all

pre-petition rights to payment are to be allowed, *except* those that are specifically excluded. In contrast, section 506(b) deals with secured claims, and directs and prioritizes the inclusion of items as part of a secured claim.

Similarly, PG&E asserts that, apart from section 506(b), when Congress intends to allow the payment of attorneys' fees, it says so expressly. Resp. Br. at 19. PG&E's catalogue of examples, however, all involve the inclusion of attorneys' fees as *priority* administrative expenses under section 503(b), *see id*. at 43, rather than as general unsecured claims under section 502. *See* 11 U.S.C. § 507(a)(2) (prescribing priority for expenses under section 503(b)). As with section 506(b), it is not surprising that, when Congress intends to give claims for attorneys' fees *priority* status, it does so by specific inclusion, but in section 502 has left the allowance of general unsecured claims to general principles (given that the category of general unsecured claims is a catch-all concept).

Finally, PG&E's theory is foreclosed because PG&E was and is a fully *solvent* debtor. As the Court observed in *Timbers*, unsecured creditors of *solvent* debtors are entitled to post-petition interest. 484 U.S. at 365. Likewise, unsecured creditors of *solvent* debtors are entitled to post-petition attorneys' fees under contracts valid under state law. *In re Dow Corning Corp.*, 456 F.3d 668, 683 (6th Cir. 2006).

3. Considerations Of Policy And History Do Not Support PG&E's Interpretation.

PG&E contends that the Court should deny all claims for post-petition attorneys' fees on the ground that allowing them would "bloat" a creditor's recovery. The theory appears to be that permitting creditors to add their post-petition fees to their claim would create an incentive to hire attorneys, litigate every issue, and then seek recovery from the debtor's estate. PG&E's argument, however, is belied by its own concessions, as well as the reality of bankruptcy recoveries: in the typical bankruptcy case: unsecured creditors recover approximately six per cent of their claims in chapter 13, seventeen percent in chapter 11, and less than one percent in

chapter 7. *See* Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results Of A Study And Analysis Of The Law*, 97 COM. L.J. 297, 322-23 (1992); Michelle J. White, *Personal Bankruptcies Under The 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1, 39 (1987/1988). It defies credulity that, given this reality, creditors would race to hire attorneys to "bloat" their claims, only to recover a fraction of their post-petition outlays.

Moreover, as PG&E concedes, over-secured creditors are entitled to collect their contractual pre-petition claims for attorneys' fees in full. Yet, when they do, this somehow poses no problem for the bankruptcy system, or challenges its essential policies. The parade of horribles that PG&E's *amici* presents also fails. The majority of circuits to have addressed the issue allow attorneys' fees to be added to unsecured claims without triggering the disaster *amici* envision. Moreover, under the *Fobian* rule, attorneys' fees have been allowed for litigating state law issues without precipitating a crisis. But even if PG&E's (and it's *amici's*) policy concerns had merit (which they do not), they offer no basis for ignoring the plain text of the Bankruptcy Code.

Similarly, contrary to PG&E's assertion, Travelers' claim is not tantamount to an "administrative expense" any more than an over-secured creditor's claim to its post-petition fees is an administrative expense. Resp. Br. at 27. Travelers seeks to recover its attorneys' fees as part of its unsecured claim under section 502. Thus PG&E's reference to "benefit to the estate" -- which is a requirement of an administrative expense, but not a claim -- is irrelevant. *See In re Abercrombie*, 139 F.3d 755, 757 (9th Cir. 1998) (listing requirements for administrative expenses under section 503).

PG&E's historical arguments are similarly unpersuasive. As Travelers demonstrated in its opening brief, and PG&E concedes, the statutory framework has changed completely since 1903 when this Court decided *Randolph & Randolph v. Scruggs*, 190 U.S. 149 (1903) -- a case that is irrelevant as involving an administrative expense obligation rather than a

general unsecured claim. The Bankruptcy Code's concept of both a "claim" and an "allowable claim" are far broader than similar concepts under its statutory predecessors. As the Court cautioned in *Ron Pair* in construing section 506(b), "it is worth recalling that Congress worked on the formulation of the Code for nearly a decade" and that "it was intended to modernize the bankruptcy laws, . . . and as a result made significant changes in both the substantive and procedural laws of bankruptcy." 489 U.S. at 240. That observation applies here. Section 502 should be construed as it is written to permit the allowance of pre-petition contractual claims for post-petition attorneys' fees -- which, as demonstrated in Travelers' brief, is fully consistent with practice under the immediate predecessor to section 502: section 63 of the former Bankruptcy Act, as amended in 1938.

B. PG&E's Reasonableness Argument Fails.

1. The Court Should Decline To Address It.

PG&E also urges the Court to recognize as a new rule of general federal common law that all claims for attorneys' fees in bankruptcy must pass an undefined federal test of reasonableness that Travelers somehow fails. The Court should decline to address PG&E's argument because the courts below refused to address it, and the issue lies outside the scope of the question presented.

2. PG&E's Argument Is Foreclosed By The Code.

PG&E's reasonableness argument is also without merit, and is foreclosed by the Bankruptcy Code. As PG&E concedes, Congress imposed an express federal requirement of reasonableness in section 506(b) before post-petition attorneys' fees may be added to a secured claim. 11 U.S.C. § 506(b); *Ron Pair*, 489 U.S. at 241 ("Recovery of fees [under section 506(b)] . . . is allowed only if they are reasonable."). In contrast, Congress imposed no similar federal restriction on the allowance of claims for fees under section 502 (other than in section 502(b)(4)). This was deliberate. For purposes of section 502, Congress incorporated whatever standard of reasonableness exists

under *state* law. Specifically, section 502(a)(1) provides that a claim shall be disallowed to the extent that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law . . . ." 11 U.S.C. § 502(b)(1). Under this provision, if a claim for attorneys' fees is unenforceable as "unreasonable" under applicable state law, it is unenforceable under section 502.

It is hardly surprising that Congress would impose its own federal reasonableness requirement on the elements of a claim entitled to priority under section 506(b), but not a general unsecured claim. Priority claims are paid ahead of all others, and Congress has chosen to limit priority entitlements as it sees fit. For example, some States allow lenders to collect a flat fee (e.g., a percentage of the amount of the loan) to cover their collection costs in the event of default. Congress has elected to screen these types of arrangements for reasonableness before they can be added to a priority secured claim. *See, e.g., Welzel v. Advocate Realty Invs., LLC (In re Welzel)*, 275 F.3d 1308, 1311 (11th Cir. 2001) (en banc) (fifteen percent of loan balance). Not so with regard to general unsecured claims, which are entitled to *no* priority. Consistent with the general policy that the substance of a claim is properly defined in the first instance by reference to state law, it is not surprising that Congress crafted the requirements of section 502 on much more of a "come as you are" basis. PG&E's contrary argument fails. *See, e.g., Welzel,* 275 F.3d at 1316-18 (fees excluded from section 506(b) are allowable under section 502); *In the Matter of 268 Ltd.*, 789 F.2d 674, 678 (9th Cir. 1986) (same).

3. Travelers' Conduct Was Reasonable.

As explained, Travelers acted reasonably in successfully protecting its rights and those of the injured workers, and it was PG&E that acted unreasonably in, among other things, unilaterally reneging on the Negotiated Language and commencing needless litigation against Travelers. Travelers has sustained a loss in the form of its fees in protecting its interests, and PG&E is liable for the same.

C. PG&E's Contract Theory Fails.

1. The Court Should Decline To Address It.

PG&E contends that Travelers' claim is not covered by one selected portion of the Indemnity Agreements. The Court should decline to address PG&E's assertion because PG&E failed to present it the court of appeals and, hence, the court of appeals had no opportunity to address it. Further, the issue lies outside the question presented because it has nothing to do with the merits of the *Fobian* rule.

2. PG&E's Argument Is Without Merit.

PG&E's argument is also without merit. PG&E cannot selectively redact the Indemnity Agreements to a single line, and then argue successfully that Travelers' claim falls outside that single line. The Indemnity Agreements require PG&E to make Travelers whole from *any loss of any kind* associated with the bonds that Travelers' issued on PG&E's behalf, including any incurrence of attorneys' fees.

More important, none of the courts below interpreted the Indemnity Agreements (which are to be construed in accordance with state law), leaving nothing for this Court to review. Although Travelers believes that it is entitled to prevail under the clear provisions of the agreements, if a court were to find that the agreements are in any relevant sense ambiguous, further proceedings would be required, and additional evidence potentially considered.[2]

CONCLUSION

The Court should reverse the decision below.

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[2] PG&E's preclusion argument, Resp. Br. 49-50 n.22, should not be considered, and is without merit. Among other reasons, PG&E could have, but failed to raise it in its opposition to the petition. Further, collateral estoppel does not apply because the *guaranty* contract in the other litigation contains very different provisions from the "all loss" provisions of the Indemnity Agreements. *People v. Garcia,* 141 P.3d 197, 210 (Cal. 2006).

Respectfully submitted,

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Dated: January 8, 2007