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FEE-SHIFTING IN BANKRUPTCY

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Daniel J. Bussel*

ABSTRACT

This Article examines attorney fee-shifting practices in bankruptcy from theoretical, historical, caselaw, statutory, empirical and comparative perspectives. Although the Supreme Court has insisted the American Rule remains the applicable background principle in insolvency cases as elsewhere, insolvency law, for sound equitable and systemic reasons, has always rejected strict application of the American Rule. Fee-shifting among the parties has been, and remains, pervasive in bankruptcy cases. Against this background, the Supreme Court's position has led to anomalous and untoward results in discrete areas where the American Rule continues to apply. This Article argues for a forthright rejection of what little remains of the American Rule in bankruptcy and proposes a modified English Rule giving bankruptcy courts discretion over the award of attorney's fees. I go on to identify a set of non-exclusive factors that properly inform the exercise of the bankruptcy court's discretion over the award of fees. Interestingly, the United Kingdom, starting from the tradition of the English Rule, has created a discretionary fee-shifting regime applicable to insolvency cases that mirrors the discretionary approach advocated here. Despite their disparate starting points, the realities of insolvency practice are impelling both the English and American systems toward a court-supervised discretionary fee-shifting regime in the bankruptcy arena.

*© 2021 by Daniel J. Bussel, Professor of Law, UCLA School of Law. I have been previously involved in litigating the issues discussed in this Article. I was one of the academic amici in support of petitioner in *Baker & Botts*, *infra* n.1 and notes 151-187 and accompanying text. See Brief Amici Curiae of Bankruptcy Law Scholars, *Baker & Botts LLP v. ASARCO LLC*, U.S. Sup. Ct. Case No. 14-103 (filed Dec. 10, 2014). I was also counsel to the National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center in filing their brief *amicus curiae* in support of respondent Aleida Johnson in *Midland Funding LLC v. Johnson*, U.S. Sup. Ct. No. 16-348 (filed Dec. 21, 2016), *infra* notes 188-201 and accompanying text. Finally, I was counsel of record for appellee Marlene Penrod in *In re Penrod*, 802 F.3d 1084 (9th Cir. 2015), *infra* notes 225-237 and accompanying text. I am grateful for the thoughtful comments on preliminary drafts from my editor the Honorable Terrence Michael and my colleagues, Professors Kenneth N. Klee, Lynn LoPucki, David Marcus, Joanna Schwartz, Michael Simkovic and Stephen Yeazell, and Thomas E. Patterson, Esq. Nicholas Redfield, UCLA School of Law Class of 2023 and Melise Knowles, UCLA School of Law Class of 2022 provided excellent research and drafting support converting those preliminary drafts and comments into this Article. Sarah Paterson of the London School of Economics and Political Science provided invaluable comments and source materials relating to current UK fee-shifting practices in insolvency cases. I also benefited from preliminary discussions with Eric Helland, Ben Nyblade and Melanie Zaber, regarding some of the empirical work that has been done in

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I. Introduction

"Our basic point of reference when considering the award of attorney's fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise"

Baker & Botts LLP v. ASARCO LLC¹

The general default rule in civil litigation in the United States, the so-called "American Rule" is that each party bears its own attorney's fees. The general default rule in the United Kingdom, and in most of the rest of the world, is the "English Rule," that is the prevailing party in civil litigation may recover its attorney's fees from its adversary as a cost of litigation. As we shall see in the discussion that follows, no system applies a pure version of either the American Rule or the English Rule in all circumstances. The thesis of this Article is that in the insolvency context we should expressly eschew reliance on the pure form of either the American Rule or English Rule, and that bankruptcy courts should authorize fee-shifts informed by a series of factors sensitive to the realities of insolvency generally and the particular case before it.

The modern Supreme Court is on unfamiliar ground when it decides bankruptcy cases. Reflexive application of general jurisprudential rules in bankruptcy cases can yield poor results. Bankruptcy is a special context where pervasive fee-shifting is already occurring, and judicial expertise in shifting and fixing attorney's fees is historically-rooted and well-developed. In that setting, reliance on the American Rule as the default rule is ahistorical and not otherwise appropriate. Moreover, it creates or exacerbates conflicts with underlying bankruptcy policy.

The discussion starts in Part II with a brief overview of the critiques and defenses of the English and American Rules respectively. Part III discusses the general fee shifting dynamics in bankruptcy and describes bankruptcy's rejection of the American Rule. Part IV identifies some areas where the American Rule's persistence has caused continuing problems in bankruptcy cases. Part V discusses the implications of the Ninth Circuit's *Penrod* decision and its progeny for fee-shifting in bankruptcy. Part VI proposes a generalized discretion in the bankruptcy court to shift prevailing party attorney fees as an appropriate corrective. Interestingly, the United Kingdom, starting from the tradition of the English Rule, has created a discretionary fee-shifting

¹576 U.S. 121, 126 (2015) (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252-53 (2010)). Justice Sotomayor concurred writing: "Given the clarity of the statutory language, it would be improper to allow policy considerations to undermine the American Rule in this case." *Id.* at 135 (Sotomayor, J. concurring).

regime applicable to insolvency cases that mirrors the discretionary approach advocated here. The realities of insolvency practice are impelling both systems toward a court-supervised discretionary fee-shifting regime notwithstanding their disparate starting assumptions. A brief conclusion follows.

II. ANALYSES OF THE ENGLISH AND AMERICAN RULES IN CIVIL LITIGATION

At the simplest conceptual level, the choice between the English and American Rules comes down to a tradeoff between providing greater incentive to assert weak claims, especially ones that carry a potential for large damages, and greater incentive to assert meritorious claims, especially small-dollar ones.² The English Rule in theory deters the holder of a long-shot claim because in the likely event the claim fails, the losing litigant incurs an additional financial penalty: responsibility for its adversary's legal fees. The American Rule deters the holder of all relatively small-dollar claims,³ regardless of merit, because even if the claimant prevails the net value of the claim will be diminished by the amount of the attorney's fees incurred to win the case.⁴ In addition, it is generally agreed that at the margins the English Rule tends to increase legal costs in the aggregate because of the litigants' optimism bias.⁵ Cases go to trial because the plaintiff's assessment of the likelihood of success exceeds the defendant's assessment of the likelihood of the plaintiff's success. The English Rule makes it harder to settle cases because each side over-discounts the risk that by going to trial it will end up having to pay both sets

²See generally Albert A. Ehrenzweig, *Reimbursement of Counsel Fees and the Great Society: In Sorrow and in Anger—and in Hope*, 54 CAL. L. REV. 792 (1966).

³"Small-dollar" in relation to the amount of expected attorney's fee. In a world where it may cost \$1 million in attorney's fees or more to bring a complex claim to final judgment even meritorious seven-figure claims may not be worth prosecuting. In some jurisdictions, even relatively straightforward meritorious claims may not be worth pursuing if the damages are less than \$100,000. See Ehrenzweig, *supra* note 2 at 795-96; Phyllis A. Monroe, *Financial Barriers to Litigation: Attorney Fees and the Problem of Legal Access*, 46 ALB. L. REV. 148, 159-61 (1981); John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U. L. REV. 1567, 1594-96 (1993).

⁴But see A. Mitchell Polinsky & Daniel L. Rubinfeld, *Does the English Rule Discourage Low Probability of Prevailing Plaintiffs*, 27 J. LEGAL STUD. 141 (1998) (demonstrating that under conditions of informational asymmetry favoring plaintiffs, marginal low-probability-of-prevailing plaintiffs who actually file claims have an incentive to go to trial rather than settle such claims). The net effect of the English Rule's tendency to discourage both the filing of weak claims and their settlement after filing, on the number of weak claims actually tried is indeterminate under the Polinsky and Rubinfeld analysis and the disincentive to settle effect of the English Rule they identify is dependent on the assumed informational asymmetry.

⁵Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L. ECON. & ORG. 143, 154-64 (1987); Edward A. Snyder & James W. Hughes, *The English Rule for Allocating Legal Costs: Evidence Confronts Theory*, 6 J.L. ECON. & ORG. 345, 376 (1990) [hereinafter Snyder & Hughes 1990]; James W. Hughes & Edward A. Snyder, *Litigation and Settlement Under the English and American Rules: Theory and Evidence*, 38 J.L. & ECON. 225, 227 (1995) [hereinafter Hughes & Snyder 1995].

of lawyers. Litigant optimism tends to both increase the plaintiff's settlement demand and decrease the defendant's offer. Fewer settlements of meritorious claims drives up the aggregate cost of resolving them. The English Rule may also drive up legal fees because clients have less incentive to constrain them, believing that the cost will be shifted to their adversaries.⁶

The English Rule is thus thought to decrease the burden of resolving weak claims (by deterring their prosecution) and to increase the burden of resolving meritorious claims (by encouraging their prosecution, raising their legal costs, and deterring their settlement).⁷ At least that is what theory, as a first approximation, predicts. Most of the world, in considering that balance, has chosen the English Rule, opting to conserve judicial resources in respect of likely meritless claims, and concentrate them on the just resolution of likely meritorious claims.⁸

To the extent that United States jurisdictions continue to cling to the American Rule,⁹ they implicitly place a premium on providing access to the judicial system for large dollar claims over smaller ones, and encouraging set-

⁶Abstract comparative analysis of the American and English Rules was a popular exercise in the law-and-economics literature of the 1970s and 1980s. See, e.g., John P. Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279 (1973); William M. Landes, *An Economic Analysis of the Courts*, 14 J.L. & ECON. 61 (1971); Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399 (1973); Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982); Richard D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067 (1989); John J. Donohue III, *Opting for the British Rule, or If Posner and Shavell Can't Remember the Coase Theorem, Who Will?*, 104 HARV. L. REV. 1093 (1991); Ivan P.L. Png, *Strategic Behavior in Suit, Settlement, and Trial*, 14 BELL J. ECON. 539 (1983); See also Snyder & Hughes 1990, *supra* note 5.

⁷Shavell, *supra* note 6; Posner, *supra* note 6; Cooter & Rubinfeld, *supra* note 6; Bradley L. Smith, *Three Attorney Fee-Shifting Rules and Contingency Fees: Their Impact on Settlement Incentives*, 90 MICH. L. REV. 2154 (1992); James W. Hughes & Elizabeth Savoca, *Measuring the Effect of Legal Reforms on the Longevity of Medical Malpractice Claims*, 17 INT'L REV. L. & ECON. 261, 269 (1997); Snyder & Hughes 1990, *supra* note 5. But see John C. Hause, *Indemnity, Settlement, and Litigation, or I'll Be Suing You*, 18 J. LEG. STUD. 157, 167-68 (1989).

⁸WALTER K. OLSON, *THE LITIGATION EXPLOSION: WHAT HAPPENED WHEN AMERICA UNLEASHED THE LAWSUIT* 329-30 (1991) (characterizing the English Rule as the "rest of the world rule" given that outside the United States almost all jurisdictions award prevailing party attorney's fees). Prior to the Supreme Court's decision in *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240 (1975), American commentators urged the federal courts to abandon the American Rule in federal litigation generally. See, e.g., Gerald T. McLaughlin, *The Recovery of Attorney's Fees: A New Method of Financing Legal Services*, 40 FORDHAM L. REV. 761 (1972); Ehrenzweig, *supra* note 2; William B. Stoebuck, *Counsel Fees Included in Costs: A Logical Development*, 38 U. COLO. L. REV. 202 (1965); Calvin A. Kuenzel, *The Attorney's Fee: Why Not a Cost of Litigation?*, 49 IOWA L. REV. 75 (1963); Charles T. McCormick, *Counsel Fees and Other Expenses of Litigation as an Element of Damages*, 15 MINN. L. REV. 619 (1931). *Alyeska's* reaffirmation of the American Rule silenced these voices urging a general abandonment. *Alyeska*, 421 U.S. at 263-271.

⁹1 MARY FRANCES DERFNER & ARTHUR D. WOLF, *COURT AWARDED ATTORNEY FEES* ¶ 1.12[1] (Lexis 2021) ("statutory exceptions to the American Rule are so frequently applicable in federal civil actions that it is not an exaggeration to say that statutory fee collection has become the rule, and the American Rule has become the exception").

tlement over trial. In addition, in many contexts, defendants are significantly less likely to be able to successfully collect shifted fees from plaintiffs than vice-versa, because plaintiffs as a class tend to be impecunious.¹⁰ In those situations, the English Rule may do little to deter weak claims and may operate only to increase the cost of resolving meritorious ones. In such contexts, the American Rule may have a decisive advantage over the English Rule. Finally, in light of the "moral hazard" associated with fee-shifting (clients who expect their adversaries to bear their legal costs have less incentive to contain them to a reasonable amount), successful implementation of the English Rule is generally thought to require either legislative or administrative regulation of legal fees or court supervision of their reasonableness. The English Rule therefore implies that the system will have to bear the burden of these administrative costs.¹¹

The net result of the theoretical examination of the policy advantages and disadvantages of the English and American Rules is, accordingly, indeterminate.¹² The practical answer to the question of when it makes sense to fee-shift is "sometimes depending on the circumstances." And just as the American Rule applies to only a small subset of cases in the United States, jurisdictions in the rest of world, while purporting to adopt the English Rule, in fact fee-shift only to a limited extent and in some circumstances.¹³

The policy implications of fee-shifting have been explored empirically in three places. These empirical studies reach conclusions broadly consistent with the summary above but also suggest the predicted effects of moving from the American Rule to the English Rule are muted in practice, only marginally affecting filing rates, settlement behavior, and litigation cost. The first place is Alaska, unique among United States jurisdictions in adopting the English Rule as a general default. Alaska's fee-shifting practices have been explored empirically in connection with reform efforts. Second, Florida undertook a much studied experiment with the English Rule in the 1980s in the context of medical malpractice litigation. Finally, Professors Eisenberg and Miller studied the incidence of prevailing party fee-shifting in significant commercial contracts filed with the Securities and Exchange Commission by reporting public companies. I summarize below what we have learned from studying the operation of the English Rule in these three settings and then

¹⁰See *infra* notes 36-50, and accompanying text (discussing Florida's experience with the English Rule in the medical malpractice cases).

¹¹See, e.g., *Oelrichs v. Spain*, 82 U. S. [15 Wall.] 211, 231 (1872) (stating the American Rule saves significant resources given the time, expense, and difficulties of proof inherent in fixing a reasonable attorney's fee).

¹²RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 22.12 at 806-11 (9th ed. 2014).

¹³Werner Pfennigstorf, *The European Experience with Attorney Fee Shifting*, 47 L. & CONTEMP. PROBS. 37 (1984); Thomas D. Rowe, Jr., *Shift Happens: Pressure on Foreign Law Attorney-Fee Paradigms from Class Actions*, 13 DUKE J. COMP. & INT'L L. 125 (2003).

discuss two intermediate forms of fee-shifting adopted or proposed in various contexts.

A. THE ALASKAN EXPERIENCE.

In its early territorial history Alaska adopted the English Rule and remains the only American state to generally reject the American Rule.¹⁴ Under Alaska Rule of Civil Procedure 82, the prevailing party is entitled to recover a percentage of its attorney's fees based on the following schedule:¹⁵

Judgment Amount	Percentage Atty Fee Due if Contested With Trial	Percentage Atty Fee Due if Contested Without Trial	Percentage Atty Fee Due if Non-Contested
First \$25,000	20%	18%	10%
Next \$75,000	10%	8%	3%
Next \$400,000	10%	6%	2%
Over \$500,000	10%	2%	1%

Several studies have focused on Alaska to test the hypothesized effects of the American and English Rules.

In a 1995 study, Susanne DiPietro and Teresa Carns examined state and federal filings in Alaska, seeking to determine whether Alaska's Rule 82 affected civil filing rates and settlement rates.¹⁶ They also conducted interviews with 161 attorneys and 29 trial judges on several topics related to Rule 82.¹⁷

The authors' major conclusion was that Rule 82 "seldom played a significant role" in Alaska's civil litigation.¹⁸ Indeed, courts awarded attorney fees awards in only 10 percent of Alaskan state court cases and 6 percent of federal court cases sampled.¹⁹ Of those fee awards, only 40 percent were

¹⁴*Alaska Rent-A-Car, Inc. v. Avis Budget Group, Inc.*, 738 F.3d 960, 972 (9th Cir. 2013) (noting that Alaska adopted the English Rule in 1884 when Congress applied the laws of Oregon to the Alaska Territory and remains unique among American jurisdictions in this regard); Douglas C. Rennie, *Rule 82 & Tort Reform: An Empirical Study of the Impact of Alaska's English Rule on Federal Civil Filings*, 29 ALASKA L. REV. 1, 7 (2012).

¹⁵See ALASKA R. CIV. P. 82 (a)-(b). When the defendant prevails, or the prevailing plaintiff does not receive a money judgment, the prevailing party recovers a percentage of its attorney's fees. ALASKA R. CIV. P. 82 (b)(2). The court will award a prevailing party without a money judgment 30 percent of reasonable actual attorney's fees in cases that go to trial, and 20 percent in cases that do not. *Id.*

¹⁶Susanne DiPietro & Teresa W. Carns, *Alaska's English Rule: Attorney's Fee Shifting in Civil Cases*, 13 ALASKA L. REV. 33, 33 n.* (1996) (stating article summarizes chapters one and two and excerpts portions of chapters three, four, five, six, nine, and ten of ALASKA JUDICIAL COUNCIL, ALASKA'S ENGLISH RULE: ATTORNEY'S FEE SHIFTING IN CIVIL CASES (October 1995)).

¹⁷*Id.* at 49 n.77, 73.

¹⁸*Id.* at 77.

¹⁹*Id.* at 78.

actually collected.²⁰ Factors such as bankruptcy, judgment-proof debtors, and fee waivers in post-judgment settlements all played roles in these outcomes.²¹

The study found no significant difference in the per capita rate of civil case filings between Alaska and other US jurisdictions, challenging the hypothesis that the English Rule deters plaintiffs from pursuing weaker claims.²² However, about half (52 percent) of plaintiffs' attorneys interviewed reported they had factored Rule 82 into a decision to assert a claim, although only 35 percent of "experienced litigators" could remember such a case.²³ Most attorneys interviewed thought the rule discouraged only plaintiffs with below-average or weak cases, but a few thought the rule also discouraged plaintiffs with strong claims but moderate means.²⁴ From the perspective of these attorneys, Rule 82 affected litigation strategy in 34 percent of cases, and affected the settlement strategy in 37 percent of cases.²⁵

The authors also discovered that Alaska had a somewhat different caseload composition than the national average, with a smaller percentage of general civil filings (including tort, contract, and real property) than the national average, and a larger percentage of domestic relations cases.²⁶ Although fee-shifting may have accounted for some of the difference in case composition, other variables peculiar to Alaska are likely at work.²⁷

Despite the apparently modest impact of fee-shifting on litigation in Alaska, the study concluded that Rule 82 had discernible effects. "It (1) discouraged some middle class parties from filing cases that either wealthy or poor plaintiffs would file, (2) discouraged some suits [and] defenses of questionable merit and (3) encouraged litigation in strong cases that might otherwise settle."²⁸

A more recent empirical study in 2012²⁹ further confirmed the modest influence of Rule 82 on civil litigation in Alaska. This study found no significant difference between civil case filing rates in Alaska and comparison American states and therefore did not support the hypothesis that the English Rule would reduce the overall number of filings by deterring prosecution of low-merit cases.³⁰ The study also found no significant difference in the

²⁰*Id.*

²¹*Id.*

²²*Id.* at 63-66.

²³ALASKA JUDICIAL COUNCIL, ALASKA'S ENGLISH RULE: ATTORNEY'S FEE SHIFTING IN CIVIL CASES 138-40 (October 1995).

²⁴*Id.*

²⁵DiPietro & Carns, *supra* note 16, at 78.

²⁶*Id.* at 66-67.

²⁷*Id.*

²⁸*Id.* at 84.

²⁹Rennie, *supra* note 14.

³⁰*Id.* at 3.

rate of civil trials or the median time from filing to disposition.³¹ These findings challenge the notion that under the English Rule the quality of claims increases.³²

The lack of definitive data from Alaska strongly supporting the predicted impacts of the English Rule could be due to Rule 82's structure.³³ Alaska does not employ a pure English Rule but rather awards only a percentage of attorney's fees, and only in certain cases. It therefore provides less of a deterrent to weak claims and less incentive to bring meritorious claims than the traditional English Rule.³⁴ Moreover, Alaska, with its small population and vast territory has a somewhat idiosyncratic civil justice system, and the studies that have been performed have significant technical limitations.³⁵

B. THE FLORIDA MEDICAL MALPRACTICE EXPERIMENT

In 1980, Florida adopted the English Rule for medical malpractice lawsuits to "screen out claims lacking in merit" and promote the "prompt settlement of meritorious claims."³⁶ The statute lasted only five years, however, and was repealed in 1985, when the medical provider and health insurance interests that had lobbied for the rule change came to realize that attorney's fees awarded to prevailing defendants were frequently uncollectible.³⁷ Nevertheless, this five-year experiment has proved to be the best available case-study for the effects of the English Rule on litigation.

One study found Florida's adoption of the English Rule shortened the duration of dropped and settled claims.³⁸ A separate study also found plaintiffs dropped their cases more often under the English Rule.³⁹ These findings support the hypothesis that plaintiffs with weak claims are more willing to settle or dismiss quickly to avoid costly litigation under the English Rule.⁴⁰ However, the studies did not find any significant difference in the duration of litigated claims under the English Rule.⁴¹

Researchers in Florida also noted defendant litigation expenditures⁴² in-

³¹*Id.* at 35-39.

³²*Id.*

³³*Id.* at 39.

³⁴*Id.*

³⁵DiPietro & Carns, *supra* note 16, at 65-66, 79 (noting the lack of control group to compare cases governed by Rule 82, differences between how states count and classify civil cases, and differences between Alaska's rural population compared to other states could all play a role in some of the study's findings).

³⁶Ch. 80-67, 1980 Fla. Laws 224.

³⁷Ch. 85-175, 1985 Fla. Laws 1180.

³⁸Hughes & Savoca, *supra* note 7, at 272.

³⁹Snyder & Hughes 1990, *supra* note 5, at 376-77.

⁴⁰Hughes & Savoca, *supra* note 7, at 269.

⁴¹*Id.*

creased significantly under the English Rule.⁴² One study found defendant spending was 108 percent higher for litigated claims and 150 percent higher for settled claims under the English Rule.⁴³ These findings support the theory that the English Rule can promote "a legal arms race," where optimistic parties increase spending that may ultimately become catastrophic for the losing party.⁴⁴ On the other hand, the findings also support the view that the English Rule deters litigation, specifically of weaker claims.⁴⁵

Finally, one study found several effects on judgment and settlement amounts.⁴⁶ Plaintiffs won judgments at a higher rate under the English Rule and their judgments were larger.⁴⁷ Settlement amounts were also higher.⁴⁸ These findings support an inference that Florida malpractice plaintiffs were less likely to pursue weaker claims under the English Rule, and only the stronger (and therefore more valuable) claims advanced into litigation.⁴⁹ The increase in average settlement and judgment amounts is therefore consistent with the prediction that under the English Rule plaintiffs are less likely to pursue weak claims and more likely to pursue meritorious ones.⁵⁰

C. THE EISENBERG/MILLER STUDY.⁵¹

In 2013, Eisenberg and Miller published an empirical study on the presence of fee shifting clauses in public company contracts.⁵² The study examined the attorney's-fee clauses in 2,347 contracts filed with the Securities and Exchange Commission in 2002 and noted the rate at which companies opted out of the American Rule.⁵³ It compared the opt-out rate for the American Rule in these public company contracts with the opt-out rates for other procedural default rules such as judicial dispute resolution (which parties may opt out of by providing for arbitration), and the right to a jury

⁴²Snyder & Hughes 1990, *supra* note 5, at 374.

⁴³*Id.*

⁴⁴Christopher R. McLennan, *The Price of Justice: Allocating Attorneys' Fees in Civil Litigation*, 12 FLA. COASTAL L. REV. 357, 382 (2011).

⁴⁵Snyder & Hughes 1990, *supra* note 5, at, 374.

⁴⁶Hughes & Snyder 1995, *supra* note 5, at 227.

⁴⁷*Id.* at 238.

⁴⁸*Id.* at 241-43.

⁴⁹*Id.* at 245.

⁵⁰*Id.* at 245.

⁵¹Eisenberg & Miller also independently studied fee-shifting in the context of class-action lawsuits. Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27 (2004). The study found the size of fees as a percentage of recovery were larger in fee-shifting cases compared to non-fee-shifting cases in class actions. *Id.* at 49-50. Fee size was also larger in federal cases than in state cases. *Id.* at 40-41. The study also found "a wider variance, as a percent of recovery," in fee-shifting cases compared to non-fee-shifting cases. *Id.* at 77.

⁵²Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327 (2013).

⁵³*Id.* at 331.

trial.⁵⁴

The study found that parties opted out of the American Rule at a substantial rate, roughly 60 percent of the time.⁵⁵ This figure was significantly higher than the rate at which parties opted out of judicial dispute resolution (11 percent) or jury trials (20 percent).⁵⁶ These data suggest that publicly traded corporations largely reject the American Rule in their most material commercial contracts. Since these agreements are typically the product of bespoke negotiations between well-represented and sophisticated parties, the revealed preference for the English Rule suggests the American Rule is often not an optimal regime for compensating attorneys in disputes over important contracts among sophisticated parties.⁵⁷

Nevertheless, parties only opted for the pure English Rule 40 percent of the time, whereas the remaining 20 percent opted for "a modified form of loser-pays arrangement."⁵⁸ Thus, parties opted for the English Rule in about the same number of cases as they explicitly or implicitly adopted the American Rule—either by specifying their preference for it or by staying silent.⁵⁹

Eisenberg and Miller's study is important in showing a market-based tendency to reject the American Rule in contract litigation.⁶⁰ While the data does not suggest a strong preference for a pure English Rule, these parties, by a substantial and statistically significant margin, did prefer some variation of a loser-pays scheme.⁶¹

D. INTERMEDIATE SOLUTIONS.

No advanced legal system applies either the English Rule or the American Rule in its pure form across all types of litigation.⁶² In the United States, the American Rule may be, and commonly is, varied by statute and by contract.⁶³ In a few situations, particularly those involving positive externalities in collective proceedings, the American Rule is overridden by equitable considerations.⁶⁴ Commonly, even when US jurisdictions depart from the American Rule, the fee-shifting regime may provide the prevailing party only partial indemnification of its legal fees, or permit indemnification only in favor of certain parties on the basis of certain showings, with respect to certain kinds

⁵⁴*Id.*

⁵⁵*Id.*

⁵⁶*Id.*

⁵⁷*Id.* at 353, 377.

⁵⁸*Id.* at 332.

⁵⁹*Id.*

⁶⁰*Id.* at 377.

⁶¹*Id.*

⁶²Pfennigstorf, *supra* note 13, at 83; see Rowe, *supra* note 13, at 128 (stating that "nearly all the rest of the world" adheres, to varying degrees, to the English rule).

⁶³See, e.g., *infra* notes 70-77, and accompanying text.

⁶⁴Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 718 (1967).

of claims, or in certain circumstances.⁶⁵ In particular, we frequently observe contractual or statutory fee-shifting (i) limited to prevailing plaintiffs⁶⁶ or (ii) limited in the discretion of the court or arbiter.⁶⁷ Moreover, even in statutes or contracts that purport to impose a pure English Rule, the court rendering judgment retains discretion to award or withhold fees based on its determination of who the prevailing party is (since it is the rare case in which either party can be said to be completely vindicated). In addition, under almost all fee-shifting regimes the court or arbiter may shift only a judicially determined "reasonable" amount of fees, an amount which may be substantially less than the amount of fees actually incurred. Finally, the practical reality that an award of attorney fees may be uncollectible from judgment-proof parties is often a decisive consideration, as both the Alaska experience and the Florida experiment with malpractice litigation demonstrate.⁶⁸

1. One Way Fee-Shifting

Many statutes that provide for fee-shifting do so only as part of the remedy for a prevailing plaintiff. Unilateral fee shifting in favor of the prevailing plaintiff recognizes that there is a public interest in encouraging private enforcement and vindication of the statutory right at issue⁶⁹ in such areas as civil rights,⁷⁰ environmental law,⁷¹ antitrust,⁷² labor law,⁷³ and in many other

⁶⁵See e.g. *supra* notes 14-35, and accompanying text (describing Alaska's Rule 82).

⁶⁶See *infra* notes 69-79, and accompanying text (describing one-way fee-shifting under regulatory statutes).

⁶⁷See *supra* notes 52-61, and accompanying text (describing contractual fee-shifting under a modified English Rule in the Eisenberg/Miller Study), and *infra* notes 80-90 and accompanying text (discussing discretionary fee shifting).

⁶⁸See *supra* notes 36-50 and accompanying text.

⁶⁹See Robert V. Percival & Geoffrey P. Miller, *The Role of Attorney Fee Shifting in Public Interest Litigation*, 47 LAW & CONTEMP. PROBS. 233, 240-41 (1984); Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L.J. 651, 662 (1982); Note, *State Attorney Fee Shifting Statutes: Are We Quietly Repealing the American Rule?*, 47 LAW & CONTEMP. PROBS. 321, 327-28 (1984). The motivation behind many such statutes is to enable financially disadvantaged parties with meritorious cases to obtain counsel in situations where contingent fees are not effective. See Issachar Rosen-Zui, *Just Fee Shifting*, 37 FLA. ST. U. L. REV. 717, 733 (2010) (noting certain fee-shifting statutes are intended to "facilitat[e] the access of low-income people to the civil justice system"). Efforts to attract counsel to represent parties with such claims via statutory fee shifting have met with mixed success, however. See, e.g., Stewart Schwab & Theodore Eisenberg, *Explaining Constitutional Tort Litigation: The Influence of the Attorney Fees Statutes and the Government as Defendant*, 73 CORNELL L. REV. 719, 759-60 (1988) (finding no clear evidence that fee shifting leads to an increase in the number of cases filed).

⁷⁰See e.g., 42 U.S.C. § 1988; 42 U.S.C. § 3613(c) (Fair Housing Act); *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717 (5th Cir. 1974) (Title VII).

⁷¹42 U.S.C. § 6972(e) (Resource Conservation and Recovery Act); see also *Fallowfield Dev. Corp. v. Strunk*, Nos. CIV. A. 89-8644, CIV. A. 90-4431, 1993 WL 157723, at *17 (E.D. Pa. May 11, 1993) (denying attorney's fee award to prevailing for-profit corporate plaintiff).

⁷²15 U.S.C. § 15 (Clayton Act).

⁷³29 U.S.C. § 216(b) (Fair Labor Standards Act).

areas regulating social and economic life.⁷⁴ For example, *prevailing plaintiffs* in civil rights cases can recover their attorneys' fees "unless special circumstances would render such an award unjust"⁷⁵ while *prevailing defendants* generally may only recover fees by showing the plaintiff's litigation position was objectively unreasonable or brought in bad faith.⁷⁶

One way fee-shifting is not only a product of a public policy judgment to affirmatively incentivize prosecution of certain types of claims that implicate third party or public interests. It is also seen as a remedy targeted at a particular shortcoming of the American Rule: That in some contexts it over-deters plaintiffs with meritorious small claims. A one way fee shift for prevailing plaintiffs in small claims litigation seems an appropriate remedy to this problem.⁷⁷

A less benign, but still ubiquitous dynamic, may also result in one way fee-shifting. When there are significant disparities in wealth and bargaining power between contractual parties, the resulting agreement may impose one way fee recovery in favor of the more powerful party.⁷⁸ A few jurisdictions, in particular California, regulate this practice by imposing reciprocal fee-shift-

⁷⁴*Davis v. Bd. of Sch. Comm'rs*, 526 F.2d 865, 868 (5th Cir. 1976) (Emergency School Aid Act of 1972, § 718, 20 U.S.C. § 1617); *Torres v. Sachs*, 69 F.R.D. 343, 348 n.5 (S.D.N.Y. 1975) (Voting Rights Act, 52 U.S.C. § 10310 (formerly cited as 42 U.S.C. § 1973(e))); *Camacho v. Bridgeport Fin., Inc.*, 523 F.3d 973, 981 (9th Cir. 2008) (Fair Debt Collection Practices Act, 15 U.S.C. § 1692k(a)(3)); *Ziegler Coal Co. v. Dir., Office of Workers' Comp. Programs*, 326 F.3d 894, 903 (7th Cir. 2003) (Longshore and Harbor Workers' Compensation Act, § 928, 33 U.S.C. § 928); *Gonter v. Hunt Valve Co.*, 510 F.3d 610, 620-21 (6th Cir. 2007) (False Claims Act, 31 U.S.C. § 3730); *Porzig v. Dresdner, Kleinwort, Benson, N. Am., LLC*, 497 F.3d 133, 143-44 (2d Cir. 2007) (Age Discrimination in Employment Act, 29 U.S.C. § 626); *Public Interest Research Grp. of N.J., Inc. v. Windall*, 51 F.3d 1179, 1190 (3d Cir. 1995) (Clean Water Act, 33 U.S.C. § 1365); *Auto Alliance Int'l, Inc. v. U.S. Customs Serv.*, 155 Fed. App'x 226, 229 (6th Cir. 2005) (Freedom of Information Act, 5 U.S.C. § 552); *Saldivar v. Rodela*, 894 F. Supp. 2d 916, 939 (W.D. Tex. 2012) (International Child Abduction Remedies Act, 42 U.S.C. § 11607(b)); *Am. Canoe Ass'n v. EPA*, 138 F. Supp. 2d 722, 746 (E.D. Va. 2001) (Clean Water Act, 33 U.S.C. § 1365, and Endangered Species Act, 16 U.S.C. § 1540); *Bd. of Trs. of Hotel & Rest. Emps. Local 25 v. JPR, Inc.*, 136 F.3d 794, 808 (D.C. Cir. 1998) (Employee Retirement Income Security Act, 29 U.S.C. § 1132(g)(2)).

⁷⁵*Newman v. Piggie Park Enter., Inc.*, 390 U.S. 400, 402 (1968).

⁷⁶*Christiansburg Garment Co. v. Equal Emp. Opportunity Comm'n*, 434 U.S. 412, 419-421 (1978) (court may only award attorney's fees to a prevailing defendant if the plaintiff's action is "frivolous, unreasonable, or without foundation, even though not brought in subjective bad faith.")

⁷⁷See, e.g. NEV. REV. STAT. 18.010(2)(a) (fee shifting in favor of prevailing plaintiffs with claims less than \$20,000). The Fair Debt Collection Practices Act, 15 U.S.C. § 1692 *et seq.*, discussed *infra* notes 189-201 is another good example. Consumer contracts with arbitration clauses that place the burden of paying the costs of arbitration of meritorious claims, including the consumer's attorney fees, on the institutional defendant are also common. See, e.g. *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 337 (2011) (describing arbitration scheme in cellular telephone consumer contracts).

⁷⁸The argument in favor of imposing reciprocal fee-shifting in this context is made comprehensively in Jeffrey C. Bright, *Unilateral Attorney's Fees Clauses: A Proposal to Shift to the Golden Rule*, 61 DRAKE L. REV. 85 (2012). Professor Bright of course refers to the Golden Rule from Christian theology, not the one followed on Wall Street, "He who has the gold, rules."

ing by operation of law in these situations.⁷⁹ But when there is a significant disparity in wealth and power between the parties, even reciprocal fee shifting may systematically favor the wealthier party because of its ability to better bear the cost and risk of litigation.

2. Discretionary Fee-Shifting

Statutes and contracts often provide for fee-shifting in conditional terms thereby authorizing (but not mandating) fee-shifting in the court's discretion rather than as of right.⁸⁰ Most federal fee-shifting statutes, and many contracts, employ such conditional language, sometimes expressly defining the scope of the discretion conferred or the relevant factors to consider in exercising that discretion.

Often, whether or not the parties or the legislature have imposed express limitations or guidance on the court's discretion, courts balance multiple factors to focus and cabin the exercise of discretion in awarding attorney's fees. The factors may be derived from precedent, legislative history, policy or equitable considerations as well as from the statute or contract conferring the fee-shifting right. Many factors guiding the courts' discretion are closely tied to the particular area of law at issue.

Many federal statutes, including the Employee Retirement Income Security Act (ERISA), the Freedom of Information Act (FOIA) and the Internal Revenue Code follow a variation of the "substantially justified" standard developed under the Equal Access to Justice Act. This standard permits a prevailing party to recover attorney's fees from its adversary, usually the government, if the court finds the adversary asserted objectively weak claims or defenses even if it acted in good faith.

Still, cases under these statutes often employ context specific factors to guide the court's determination of whether it is reasonable to shift fees under this standard.

In ERISA cases courts employ a five-factor test that looks to:

- (1) the degree of the offending parties' culpability or bad faith;
- (2) the degree of the ability of the offending parties to personally satisfy an award of attorney's fees;
- (3) whether or not an award of attorney's fees against the offending parties would deter other persons acting under similar circumstances;

⁷⁹See *infra* note 214 and accompanying text, discussing reciprocal fee-shifting under CALIFORNIA CIVIL CODE § 1717.

⁸⁰DERFNER & WOLF, *supra* note 9, at ¶ 5.12.

- (4) the amount of benefit conferred on members of the pension plan as a whole;
- (5) the relative merits of the parties' position.⁸¹

These considerations must be weighed in the exercise of the court's discretion but no single one is necessarily controlling.⁸²

FOIA's legislative history presents another context specific list of relevant fee-shifting factors:⁸³

- (1) The benefit to the public, if any, deriving from the case;
- (2) The commercial benefit to the complainant;
- (3) The nature of the complainant's interest in the records sought; and
- (4) Whether the government's withholding of the records sought had a reasonable basis in law.

Each factor should be independently considered.⁸⁴ However, the fourth factor is deemed to be the most important; courts have denied fee awards even though the first three factors were met.⁸⁵

The fee-shifting provision in the Internal Revenue Code allows taxpayers to recover attorney's fees in actions "relating to the determination, collection, or refund of any tax."⁸⁶ A court can deny the taxpayer a fee award if the government is deemed to be substantially justified in its position.⁸⁷ Some factors courts consider when making a determination of whether the government is substantially justified are:

- (1) The reasonability of the government's position as to the underlying tax dispute;
- (2) The novelty or uncertainty of the litigated issues;
- (3) The existence or absence of precedent or other supporting law for the government's position;

⁸¹*Eaves v. Penn.*, 587 F.2d 453, 465 (10th Cir. 1978). See DERFNER & WOLF, *supra* note 9, at ¶ 10.22 n.5 (listing cases from each federal court of appeals adopting *Eaves* test) & *id.* at n.9 (listing cases); see also *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 245 (2010) (fee claimant need not prevail in the overall suit but must show some success on merits for a court to award attorney fees) & *id.* at 253 n.8, 255 (five factor test may be considered by court in awarding fees).

⁸²See DERFNER & WOLF, *supra* note 9, at ¶ 10.22 n.9 (listing cases shifting fees on varying showings under the five factor test).

⁸³S. REP. NO. 93-854, at 19 (1974).

⁸⁴*Id.* at 19-20.

⁸⁵See DERFNER & WOLF, *supra* note 9, at ¶ 10.23 (2020); *Morley v. CIA*, 894 F.3d 389, 392-97 (D.C. Cir. 2018).

⁸⁶DERFNER & WOLF, *supra* note 9, at ¶ 10.25 (2020); 26 U.S.C. § 7430.

⁸⁷See DERFNER & WOLF, *supra* note 9, at ¶ 10.25.

- (4) The existence or absence of factual evidentiary support for the government's position.⁸⁸

The list of relevant factors grows longer and more vague when the fee-shifting right is divorced from a particular statutory or contractual context. For example, Alaska's Rule 82 although providing for the English Rule and prescribing a fixed schedule for the court to use in imposing a fee-shift⁸⁹ also lists eleven open-ended factors on which judges can base an adjustment of the attorney's fee award prescribed by the Rule:

- (1) the complexity of the litigation;
- (2) The length of trial;
- (3) The reasonableness of the attorneys' hourly rates and the number of hours expended;
- (4) The reasonableness of the number of attorneys used;
- (5) The attorneys' efforts to minimize fees;
- (6) The reasonableness of the claims and defenses pursued by each side;
- (7) Vexatious or bad faith conduct;
- (8) The relationship between the amount of work performed and the significance of the matters at stake;
- (9) The extent to which a given fee award may be so onerous to the non-prevailing party that it would deter similarly situated litigants from the voluntary use of the courts;
- (10) The extent to which the fees incurred by the prevailing party suggest that they had been influenced by considerations apart from the case at bar, such as a desire to discourage claims by others against the prevailing party or its insurer;
- (11) Other equitable factors deemed relevant.⁹⁰

* * *

This brief survey of various discretionary fee-shifting regimes leads to the conclusion that a decision to move to a discretionary fee-shifting regime in a particular area of law is only the first step in a two-step process. It is not enough to decide that in a particular area fee-shifting is *sometimes* appropriate and confer an open-ended discretion upon the court. One must also consider when and under what particular circumstances and to what extent the fee shift is appropriate in order to help guide that exercise of discretion. The

⁸⁸*Id.*

⁸⁹ALASKA R. CIV. P. 82.

⁹⁰ALASKA R. CIV. P. 82(b)(3).

factors that are relevant to that decision are likely to be context specific, non-exclusive, and of varying weights, and may operate differently depending upon whether the fees are sought by plaintiff rather than defendant or private party rather than a government or other institutional entity.

III. ATTORNEY'S FEES IN BANKRUPTCY

A. FEE-SHIFTING IN BANKRUPTCY TODAY.

The assumption that the "bedrock principle known as the American Rule" is the proper default rule with respect to attorney's fees in bankruptcy is a mistake. *Baker & Botts* is only one case in point;⁹¹ the mistake has been repeated numerous times, and not just by the Supreme Court.

It blinks reality to declare that the bedrock principle in bankruptcy is each litigant pays its own attorney's fees.

- Chapter 11 debtor's counsel is compensated by the bankruptcy estate. Since most bankruptcy debtors are insolvent, that compensation is effectively borne by the debtor's creditors. If insufficient unencumbered assets exist to pay those fees out of the estate as a matter of practice the secured creditor will bear those fees out of its collateral pursuant to a court-approved carve-out.⁹²
- The secured creditor's fees are commonly shifted to the estate as well either by operation of law in the case of a secured party whose collateral value exceeds the amount of its claim under section 506(b), or pursuant to the terms of financing orders routinely entered at the beginning of the case affording the secured party "adequate protection" under sections 361 and 363.⁹³
- Unsecured creditors are represented by an official committee also entitled to retain counsel at estate expense. If an equity committee is appointed, public shareholders too may shift the burden of paying their counsel to the estate and if

⁹¹See *supra* note 1 & *infra* notes 151-187 and accompanying text.

⁹²11 U.S.C. §§ 327-31, 363-64, 503(b)(1). The economic incidence of the estate's administrative expenses falls on different constituents in different cases. See also Richard B. Levin, *Almost All You Ever Wanted to Know About Carve Out*, 76 AM. BANKR. L.J. 445 (2002). It is often unclear whether the burden of the financing order carve-out is intended to fall on the secured party or on the estate generally. *Id.* at 448-51. Although financing orders with carve-outs are approved under section 363 (use of estate property including cash collateral) and 364 (post-petition financing) nothing in those sections explicitly provides for either fee-shifting or carve-outs. Fee-shifting in favor of individual debtor's counsel also occurs in the Chapter 12 and Chapter 13 context. *In re Steen*, 631, B.R. 704, 2021 WL 2877515 at *4-8 (Bankr. N.D. Tex. July 7, 2021) (§ 330(a)(4)(B) authorizes payment of individual debtor's counsel from estate in discretion of court).

⁹³11 U.S.C. § 361, 363-64, 506(b).

that estate is insolvent effectively force creditors generally to bear that cost including creditors in constituencies adverse to the committee.⁹⁴

- Bankruptcy trustees commonly are members of the law firms they retain to represent them.⁹⁵ For them legal fees are not a cost but a profit center. Indeed, the generous compensation afforded to the trustee's attorneys commonly dwarf the relatively stingy statutory commission available to compensate the trustee himself.⁹⁶

- Non-debtor parties to unexpired leases and executory contracts may enjoy a statutory claim to post-bankruptcy attorney's fees upon assumption and reinstatement of their contracts under section 365(b) as a part of the right to cure and adequate assurance of future performance if their contracts so provide. Attorney's fee claims under assumed contracts and leases are paid as administrative claims with priority over all other unsecured and priority pre-petition claims.⁹⁷

- Contractual creditors, even those whose contracts are not assumed and without sufficient collateral to enjoy a statutory claim to post-bankruptcy attorney's fees under section 506(b), commonly may add attorney's fees incurred in bankruptcy to their claim and receive a pro rata distribution of their claims along with other unsecured creditors. In those jurisdictions in which reciprocal fee shifting rights exist, if these creditors wind up in litigation with the debtor or trustee and do not prevail, they may wind up paying the fees of debtor's or trustee's counsel.⁹⁸

⁹⁴11 U.S.C. §§ 330(a)(1), 503(b), 507(a)(2) and 1102-03.

⁹⁵There is no impropriety in a trustee employing his otherwise qualified law or accounting firm to render necessary professional services after making full disclosure of his connections to the firm to the court and the parties in accordance with the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure and obtaining the consent of the U.S. Trustee and the court. 3 COLLIER ON BANKRUPTCY ¶ 327.04[8] (16th ed. 2020) ("Section 327(d) specifically permits the court to authorize a trustee to act as attorney or accountant for the estate but requires the court to find that such authorization is in the best interest of the estate. . . . The selection of the trustee might be made largely with the view of consolidating the functions of trustee and attorney [or accountant] in one person for the purpose of reducing the cost of administering the case.")

⁹⁶Compare 11 U.S.C. §§ 326 and 330(a)(7) (fixing trustee compensation), with *id.* at §§ 327, 328 and 330(a)(1)-(4) (standards for allowance of fees and expenses of professional persons).

⁹⁷11 U.S.C. §§ 365(b), 503(b), 507(a)(2).

⁹⁸*Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007); *In re Penrod*, 802 F.3d 1084 (9th Cir. 2015). These cases are discussed *infra* notes 212-218, and accompanying text. Note that if the non-debtor party is solvent the "reciprocal" fee award will be payable at 100 cents on the dollar while the

- Fee-shifting is also available as damages or a sanction for violations of the automatic stay, the bankruptcy discharge, or other court orders. The bankruptcy court has inherent power to assess attorney's fees against a party on the basis of bad faith misconduct and express statutory authority to do so in the case of paid petition preparers. Rule 9011 sanctions also may include the payment of the counterparty's attorney's fees.⁹⁹

- Parties making "substantial contributions" to a bankruptcy case may also apply to the court for an allowance of attorney's fees out of the estate or may negotiate for such payment under the terms of a negotiated plan. Indenture trustees, unofficial committees and other non-bankruptcy fiduciaries may collect their fees out of the distributions otherwise payable to their constituencies even in the absence of making a substantial contribution to a case.¹⁰⁰

- Expenses incurred for the preservation of collateral (including fees of estate professionals) may sometimes be surcharged against that collateral, effectively shifting the fees to the secured party.¹⁰¹

- Disappointed stalking horse bidders may receive fee reimbursement under the terms of court-approved bidding procedures.¹⁰²

- Debtors may recover their attorney's fees from petition-

prevailing creditor's claim for attorney's fees under the contract will only be paid *pro rata* with other unsecured claims at a level that will be determined by the depth of the debtor's insolvency. See also *In re Hawkeye Ent., LLC*, 625 B.R. 745 (Bankr. C.D. Cal. 2021) (awarding prevailing debtor nearly \$606,000 in attorney's fees in lease assumption litigation).

⁹⁹11 U.S.C. §§ 105(a) (orders in aid of jurisdiction), 110(i) (recovery of debtor's counsel fees from paid petition preparers), 362(k) (damages from violation of automatic stay), 524 (discharge injunction); see also FED. R. BANKR. P. 9011; 28 U.S.C. § 1927. Bankruptcy courts also commonly invoke their "inherent powers" to award compensatory sanctions for litigant or professional misconduct in the form of granting or denying compensation for attorney fees. See, e.g., *Chambers v. NASCO, Inc.*, 501 U.S. 32, 50 (1991); *In re Dyer*, 322 F.3d 1178, 1187 (9th Cir. 2003); *In re Caranchini*, 160 F.3d 420, 423 n.3 (8th Cir. 1998); *In re Rimsat, Ltd.*, 212 F.3d 1039, 1047 (7th Cir. 2000). But see *Taggart v. Lorenzen*, 139 S.Ct. 1795, 1801 (2019) (imposing civil contempt standard of "no objectively reasonable basis for concluding that the creditor's conduct might be lawful" on discharge violation sanctions). The inherent powers of bankruptcy courts, which do not exercise the full breadth of the federal judicial power under the Constitution, may be more circumscribed than those of the Article III judiciary in some instances. See, e.g., *In re Courtesy Inns, Inc.*, 40 F.3d 1084, 1086 (10th Cir. 1994) (bankruptcy court not "court of the United States" under 29 U.S.C. § 1927).

¹⁰⁰11 U.S.C. § 503(b)(3), (4).

¹⁰¹11 U.S.C. § 506(c). But see *GECC v. Levin & Weintraub*, 739 F.2d 73, 76-77 (2d Cir. 1984); *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 8-9 (2000).

¹⁰²Expense reimbursement and break-up fees for stalking horse buyers are commonly approved under 11 U.S.C. § 363. DANIEL J. BUSSEL, DAVID A. SKEEL, JR. & MICHELLE M. HARNER, BANKRUPTCY

ing creditors if they succeed in dismissing an involuntary case.¹⁰³

- Socialization of the parties' legal costs is a common feature of court-approved bankruptcy settlements both outside and under a reorganization plan.¹⁰⁴

As this non-exclusive list makes clear, it turns out that in bankruptcy, at the end of the day, most of the major parties are not bearing their own attorney's fees. An extraterrestrial observing the scene from the heavens could be forgiven for viewing chapter 11 as a creative mechanism for retaining, compensating, and shifting the cost of attorneys and other professionals among the parties.

But bankruptcy is more than an engine for the creation and distribution of professional fees. It is a collective proceeding that involves a multiplicity of parties with both cooperative and competing interests rife with strategic behavior that may include pretextual or meritless assertion of claims and objections. Although strategic litigation behavior is certainly not limited to bankruptcy cases, these problems multiply in the context of complex collective proceedings. Given the number of parties, the immense range of activity regulated by the bankruptcy court, and the ease of access to the bankruptcy court, strategic litigation by bullies, hold-outs, and squeaky wheels are endemic concerns in bankruptcy.

Appellate courts are largely insulated from this behavior by the substantial barriers to appellate review they (with an assist from Congress) have erected in the form of standing,¹⁰⁵ mootness¹⁰⁶ and finality doctrines.¹⁰⁷ Col-

889-92 (11th ed. 2021); see also Bruce A. Markell, *The Case Against Break-up Fees in Bankruptcy*, 66 AM. BANKR. L. J. 349 (1992).

¹⁰³11 U.S.C. § 303(i). Similarly, debtors may recover their attorney's fees from bankruptcy petition preparers who have committed fraudulent, unfair or deceptive acts. 11 U.S.C. § 110(i).

¹⁰⁴This practice of socializing the legal costs of key constituents in reorganization proceedings predated statutory fee-shifting in bankruptcy. It was an established part of the judicially created federal equity receivership practice that formed the model for modern chapter 11 and former statutory reorganization procedures under the Chandler Act and 11 U.S.C. § 77B. *United States v. Chicago, M., St. P. & P.R. Co.*, 282 U.S. 311, 319-20 (1931) (describing equity receivership plan compensation provisions for multiple committees of creditors, stockholders and managers).

¹⁰⁵Appellate standing in bankruptcy is limited to "persons aggrieved," that is those with a pecuniary interest in the outcome of the appeal, a category that excludes many parties in interest that meet constitutional standing requirements. *In re El San Juan Hotel*, 809 F.2d 151, 154 (1st Cir.1987); *In re Fondiller*, 707 F.2d 441, 443 (9th Cir.1983).

¹⁰⁶Much of the strategic behavior in bankruptcy involves disputes over interlocutory matters from which no appeal of right lies. Although interlocutory appeals may be taken to the federal district court or bankruptcy appellate panels, doing so requires leave of the appellate court. Appellate courts including the Supreme Court sometimes stretch the meaning of finality to pragmatically permit review of discrete proceedings. See generally *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 140 S. Ct. 582 (2020). But in other instances such consequential rulings as the denial of confirmation of a reorganization plan may escape appellate review. *Bullard v. Blue Hills*, 575 U.S. 496, 503 (2015).

lectively, these doctrines sharply limit the ability of parties to use appellate process to delay or obstruct bankruptcy proceedings for purposes of obtaining leverage in negotiations.¹⁰⁸ But control over the allowance and incidence of legal fees is one of the important levers that bankruptcy courts have to limit such destructive strategic behavior at the trial level.

Finally, sound fee-shifting regimes depend upon a mechanism for state regulation or court supervision of the amount of fees being shifted. Accordingly, the bankruptcy courts, in coordination with the Office of the United States Trustee, have evolved elaborate mechanisms for routinely assessing the reasonableness and payment of attorney's fees subject to court allowance.¹⁰⁹

In this context it is fatuous to treat the American Rule as a basic point of reference for allocating attorney's fees among the parties in bankruptcy. Fee-shifting is pervasive; the bankruptcy court and US Trustee are directly involved in reviewing the fees; sometimes it is almost impossible to figure out who is actually footing the bills. Neither the American Rule nor the English Rule is the baseline or background principle. This is as true in American practice as it is in the United Kingdom.¹¹⁰

B. THE HISTORICAL EQUITABLE EXCEPTIONS TO THE AMERICAN RULE UNDERGIRDING FEE SHIFTING IN BANKRUPTCY.

Perhaps, as *Baker & Botts* claimed, in 1796 "[t]he general practice of the United States [was] in opposition" to forcing one side to pay the other's attorney's fees, and "even if that practice [is] not strictly correct in principle, it is entitled to the respect of the court, till it is changed, or modified, by

¹⁰⁷When final orders are entered, unless a stay pending appeal issues, changes in position by the parties in reliance on the orders may effectively preclude appellate review under equitable mootness doctrines. Equitable mootness is discussed at length in *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015). In cases involving bankruptcy sales or financing, these equitable principles are codified and expanded by statute. 11 U.S.C. §§ 363(m); 364(e). Stays pending appeal generally require the posting of substantial bonds and are rarely obtained.

¹⁰⁸See Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. (forthcoming 2022); Daniel J. Bussel, *Textualism's Failures: A Study of Overruled Bankruptcy Decisions*, 53 VAND. L. REV. 887, 918-21 nn.108-110 (2000).

¹⁰⁹See, e.g., BANKR. S.D.N.Y. R. 2016-1 (Compensation of Professionals); BANKR. D. DEL. R. 2016-2 (Motions for Compensation and Reimbursement of Expenses); Appendix B: *Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under United States Code by Attorneys in Larger Chapter 11 Cases*, 78 FED. REG. 36,248 (June 17, 2013); *Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. § 330*, 28 C.F.R. Pt. 58 App. A (2021).

¹¹⁰The insolvency exception to the English Rule in UK reorganization practice is discussed *infra* notes 270-272 and accompanying text. See also CHRIS HOWARD & BOB HEDGER, *RESTRUCTURING LAW & PRACTICE* ¶¶ 4.106-4.107 (LexisNexis 2d ed. 2014) ("The range, type and structure of fees payable on a restructuring are only really limited by the imagination of the various constituencies and their respective advisors The quantum of such fees remains negotiable, but market practice has clearly developed and fees will be paid in almost all circumstances.")

statute."¹¹¹ The general practice of the United States bankruptcy courts, however, consistent with the existing statutory scheme enacted by Congress, does not make attorney's fees strictly a matter of contract between lawyer and client.¹¹² Indeed, even in the 19th century when the American Rule became otherwise broadly entrenched in United States practice, courts recognized that collective proceedings (such as bankruptcy cases) involved special considerations requiring equitable exceptions to the American Rule.¹¹³ Pervasive fee-shifting subject to court supervision is the historical practice in bankruptcy. The federal common law out of which the American Rule grew also incorporated these exceptions and grafted them onto the American Rule. This historic practice is equally entitled to the respect of the appellate courts unless Congress explicitly directs otherwise.

Three main categories of equitable exceptions to the American Rule developed in the caselaw in the 19th century: (1) common fund, (2) substantial benefit, and (3) bad faith and contempt. For present purposes, I will leave the bad faith exception to the side. There is broad agreement inside and outside of bankruptcy that discretionary fee-shifting is appropriate in situations where the prevailing party has been forced to fight off bad faith or frivolous claims and defenses.¹¹⁴

¹¹¹*Baker & Botts LLP v. ASARCO LLC*, 576 U.S. 121, 135 (2015) (quoting *Arcambel v. Wiseman*, 3 U.S. 306, 306 (1796)). In fact, it is probably not true that the American Rule was the general practice in 1796. John Leubsdorf, *Toward a History of the American Rule on Attorney Fee Recovery*, 47 LAW & CONTEMP. PROB. 9, 10-13 (1984) explains that in the 18th century virtually all colonial legislatures in British America regulated attorney's fees by statute, and American courts routinely awarded the regulated fee to the prevailing party in accordance with British practice. Beginning towards the end of the 18th century and into the 1820s legislative regulation of attorney's fees fell into desuetude, and the state-approved fee schedules were increasingly ignored or repealed, because market prices exceeded the regulated rates by a large margin. As regulation faded, attorney's fees were set at market rates determined by contract between attorney and client. At this point, the American Rule emerged as the dominant rule since any fee-shifting regime depends on either state regulation or court supervision of the fees being shifted. By the middle of the 19th century state regulation of attorney's fees and court supervision of prices freely negotiated in the marketplace had fallen into deep disfavor. Historically, the emergence of the American Rule appears to have been tied to the desire to eliminate state regulation of legal fees, not any desire to increase access to justice. *Id.*

¹¹²Indeed, the pre-Code practice with respect to the allowance of attorney's fees incurred in defense of fee applications, the specific issue at stake in *Baker & Botts*, was that recovery of the fees by the prevailing applicant were allowable in the court's discretion. See *infra* notes 151-165, and accompanying text.

¹¹³See *Sprague v. Ticonic Nat'l Bank*, 307 U.S. 161 (1939). That exception had previously been applied in cases where a plaintiff traced or created a common fund for the benefit of others as well as himself. *Cen. R.R. & Banking Co. v. Pettus*, 113 U.S. 116 (1885); *Trustees v. Greenough*, 105 U.S. 527 (1881). *Sprague* itself involved a variation of the common fund situation where, although the plaintiff had not in a technical sense sued for the benefit of others or to create a common fund, the stare decisis effect of the judgment obtained by the plaintiff established as a matter of law the right of a discernible class of persons to collect upon similar claims. *Sprague*, 207 U.S. at 163. The Court held that the general equity power "to do equity in a particular situation" supported an award of attorney's fees under such circumstances for the same reasons that underlay the common fund decisions. *Id.* at 166-67.

¹¹⁴See e.g. FED. R. BANKR. P. 9011.

The common fund exception allows a prevailing party to collect attorney's fees from a common fund when others (who did not actively participate in the litigation) benefited from the litigation via the creation, protection, or enhancement of that fund. The award is taken out of the common fund as a way of preventing the beneficiaries from being unjustly enriched.

The substantial benefit exception overlaps with the common fund exception and applies when others have benefited as a result of the prevailing party's litigation even in the absence of a common fund. This exception typically arises when the beneficiaries are sufficiently represented by the defendant and so the court shifts the prevailing plaintiff's fees onto the defendant, who is then in position to spread the costs across the benefiting parties appropriately. There are two primary subcategories of cases under the substantial benefit exception discussed below: corporate therapeutics cases and union democracy cases.¹¹⁵

Both the common fund and substantial benefit cases drew heavily on bankruptcy precedent.¹¹⁶

The common fund exception to the American Rule permits a prevailing party or the prevailing party's attorney to recover attorney's fees from a common fund resulting from the prevailing party's successful prosecution of its claims creates a common fund benefiting itself and others.¹¹⁷ The exception is based "on the perception that persons who obtain the benefit of a lawsuit without contributing to its costs are unjustly enriched at the successful litigant's expense."¹¹⁸ Typically, a party recovers its fees from a fund that is created as a result of litigation, but a party may recover where they "enhance, preserve, or protect" a fund.¹¹⁹ Thus, it is not necessary that the fund was created as a result of litigation. The fund must be under control of the court, such that the court can compel a payment from that fund.¹²⁰ Furthermore, the award must be made before a fund has been fully distributed to its beneficiaries.¹²¹

The common fund exception was the first equitable exception to the American Rule recognized by the Supreme Court, in *Trustees v. Greenough*.¹²² In *Greenough* the plaintiff, on behalf of himself and other bondhold-

¹¹⁵See *infra* notes 136-148 and accompanying text.

¹¹⁶See *infra* notes 122-126, and accompanying text.

¹¹⁷DERFNER & WOLF, *supra* note 9, at ¶ 2.10.

¹¹⁸*Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980).

¹¹⁹*Abbott, Puller & Myers v. Peyser*, 124 F.2d 524, 525 (1941).

¹²⁰See DERFNER & WOLF, *supra* note 9, at ¶ 2.30; *Trustees v. Greenough*, 105 U.S. 527, 536 (1882).

¹²¹See DERFNER & WOLF, *supra* note 9, at ¶ 2.30; *Wyser-Pratte v. Van Dorn Co.*, 49 F.3d 213, 218-19 (6th Cir. 1995); *National Ass'n for Mental Health v. Califano*, 717 F.2d 1451, 1456-57 (D.C. Cir. 1983).

¹²²105 U.S. 527 (1881). *Greenough*, however, is hardly the first American authority recognizing a bankruptcy exception to the American Rule. *Greenough* relied on a long line of authorities stretching back

ers, successfully sued the trustees of a Florida railroad company for corruptly selling land to insiders at nominal prices.¹²³ After entering judgment for the recovery of the fraudulent transfers, the court went on to award attorney's fees to the plaintiff because it was unjust for him to solely bear the costs of litigation where the other bondholders had benefited on a pro rata basis.¹²⁴ The *Greenough* Court noted parties had historically been entitled to attorney fees where a fund was created for the benefit of creditors in bankruptcy cases:

The rule that a party who recovers a fund for the common benefit of creditors is entitled to have his costs and expenses paid out of the fund, prevails in bankruptcy cases. In *Worrall v. Harford*, Lord Eldon said: 'The petitioning creditor is answerable till the assignment. Can there be a doubt that the assignees, if there be nothing special in the deed, would have a clear right to pay all the expenses incurred? It would be implied if not expressed.' This rule has been followed by the District Courts of the United States. See a forcible opinion of Judge Bryan, *In re Williams*, in the District Court of South Carolina; and *In the Matter of O'Hara*, in the western district of Pennsylvania. In a case in Massachusetts before Judge Lowell the same rule was adopted. The petitioning creditors charged as an act of bankruptcy the execution of a mortgage by the debtors, and having succeeded, after much opposition, in substantiating the charge, they asked that counsel fees should be allowed them out of the estate.¹²⁵

to the English Chancery court that recognized that fee-shifting operated differently in bankruptcy and other common-fund cases. *Id.* at 533-36. Those principles operated to create non-statutory equitable exceptions to the American Rule when transported across the Atlantic and applied to bankruptcy cases. The continuing vitality of those principles was recognized in *Matter of O'Hara*, 17 [8 New Series] AM. L. REG. 113, 117 (W.D. Pa. 1869) ("The strong equities of the petitioner's case are not difficult to discover; and the practice under the [Bankruptcy Act] of 1841 was to allow such a charge out of the assets . . . As the solution of this question does not depend upon any statutory provision, and, as a precedent, is of consequence to the profession and the public, before concurring with the Register, I have given to the subject mature consideration. I have arrived at the conclusion that his opinion is based on sound principles, and sustained by sufficient authority. The fund is within the control of the court, and it is our province so to administer it as to do exact justice to all the creditors. We have judicial knowledge of the professional services rendered by able counsel of the petitioning creditors, by whose exertions the fund has been realized; and as we consider the fee charged reasonable, it is proper that their compensation, as one of the incidental expense, should be deducted before distribution."); see also *In re Williams*, 2 BANKR. REG. 28 (D.S.C. 1868) (fees of prevailing petitioning creditor allowable against the insolvent estate as determined by court); *Ex parte Plitt*, 19 Fed. Cases 875, 2 Wall. Jr. 453 (E.D.Pa. 1853) (intestate estate).

¹²³*Greenough*, 105 U.S. at 528-30.

¹²⁴*Id.* at 532.

¹²⁵*Id.* at 534 (citations omitted).

Similar understandings widely prevailed at the time of *Greenough* in the context of reorganizations conducted through equity receivership practice:

In the vast amount of litigation which has arisen in this country upon railroad mortgages, where various parties have intervened for the protection of their rights, and the fund has been subjected to the control of the court and placed in the hands of receivers or trustees, it has been the common practice, as well in the courts of the United States as in those of the States, to make fair and just allowances for expenses and counsel fees to the trustees, or other parties, promoting the litigation and securing the due application of the property to the trusts and charges to which it was subject. Sometimes, no doubt, these allowances have been excessive, and perhaps illegal; and we would be very far from expressing our approval of such large allowances to trustees, receivers, and counsel as have sometimes been made, and which have justly excited severe criticism.

Still, a just respect for the eminent judges under whose direction many of these cases have been administered would lead to the conclusion that allowances of this kind, if made with moderation and a jealous regard to the rights of those who are interested in the fund, are not only admissible, but agreeable to the principles of equity and justice.¹²⁶

Just three years later in *Central Railroad & Banking Co. v. Pettus*,¹²⁷ the Supreme Court expanded the common fund exception to allow attorneys to directly recover their fees from a common fund.¹²⁸ In *Pettus*, the Court granted a lien on a common fund's assets to the prevailing party's attorneys in case other creditors who benefited from the judgment refused to pay extra legal fees.¹²⁹

The next major precedent on the common fund exception to the American Rule came in *Sprague v. Ticonic National Bank*, where the Court allowed an attorney fee award despite the fact the suit was not brought for the benefit of other depositors.¹³⁰ Still, the Court awarded attorney fees because "in

¹²⁶*Id.* at 536-37.

¹²⁷113 U.S. 116 (1885).

¹²⁸*Central Railroad & Banking Co.*, 113 U.S. at 127. But see John P. Dawson, *Lawyers and Involuntary Clients: Attorney Fees from Funds*, 87 HARV. L. REV. 1597, 1603 (1974) (criticizing the *Pettus* extension of *Greenough* and arguing that direct recovery to attorneys of compensation in excess of their contractual entitlement with their client under the common fund exception can only be explained by "guild" attitudes shared by judges and lawyers as members of a shared profession).

¹²⁹Dawson, *supra* note 128, at 1604.

¹³⁰*Sprague v. Ticonic Nat'l Bank*, 307 U.S. 161, 166 (1939).

view of the consequences of stare decisis, the petitioner by establishing her claim necessarily established the claims of fourteen other trusts pertaining to the same bonds."¹³¹ Thus, it did not matter the plaintiff had formally brought the claim on behalf of solely herself as the claims of those similarly situated could be easily established and collected given the "stare decisis" effect of her judgment.¹³²

In *Boeing Co. v. Van Gemert*, the Supreme Court expanded the awarding of attorney's fees to unclaimed portions of a common fund.¹³³ Even though the defendant had a claim on the remaining unclaimed money from the fund, the court concluded this "may not defeat each class member's equitable obligation to share the expenses of litigation."¹³⁴ *Boeing* allowed plaintiffs' attorney's fee awards to be collected from a total fund available to class members even if some of the fund was ultimately returned to the defendant because a number of putative beneficiaries failed to file timely claims.¹³⁵

The substantial benefit exception is similar in principle to the common fund exception.¹³⁶ The key distinction is that under the substantial benefit exception there is no common fund for the award to be taken out of. The court in *Mills v. Electric Auto-Lite* described this doctrine as "permit[ing] reimbursement in cases where (1) the litigation has conferred a substantial benefit (2) on the members of an ascertainable class, and (3) where the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the costs proportionately among them."¹³⁷ The court in *Mills* also clarified that a substantial benefit "must be something more than technical in its consequence and be one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest."¹³⁸ Indeed, the benefit conferred is not required to be monetary although of course, it usually is.¹³⁹

¹³¹*Id.*

¹³²Although the *Sprague* court purported to rely on "stare decisis" as the benefit conferred justifying attorney fee-shifting, in modern terms *Sprague* appears to turn on the benefit *Sprague* afforded similarly situated non-party beneficiaries of the prior ruling for offensive use of issue preclusion against the common defendant in the same forum on the basis of her prior judgment. See REST. OF JUDGMENTS (SECOND) § 29. It is not plausible to interpret *Sprague* as conferring a continuing lien in favor of an attorney who merely establishes a favorable controlling precedent against recoveries by nonparty plaintiffs from nonparty defendants in future litigation. No court appears to have done so. Dawson, *supra* note 128, at 1610-11.

¹³³*Boeing Co. v. Van Gemert*, 444 U.S. 472 (1980).

¹³⁴*Id.* at 747.

¹³⁵DERFNER & WOLF, *supra* note 9, at ¶ 2.01.

¹³⁶*Id.* at ¶ 3.01.

¹³⁷*Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 393-94 (1970).

¹³⁸*Id.* at 396.

¹³⁹See *Koppel v. Wien*, 743 F.2d 129, 133-34 (2d Cir.1984) (finding it "irrelevant to plaintiffs' entitlement to attorney's fees. . .that the amount of the benefit conferred may not be precisely ascertained.").

This exception does not permit a court to shift fees as "an added penalty to the defendants."¹⁴⁰ Thus, an attorney's fee award can only come from a defendant if the defendant represents the beneficiaries of the plaintiff's efforts. The Supreme Court has expressly recognized the substantial benefit exception in two contexts: (1) corporate therapeutics cases and (2) union democracy cases.¹⁴¹ Moreover, the Bankruptcy Code itself expressly codifies and expands both the *Greenough* and *Pettus* principles of charging the estate for the attorney's fees of parties that render a "substantial contribution" to the bankruptcy case, including, but not limited to, the recovery for the benefit of the estate of property wrongfully transferred by the debtor.¹⁴²

Corporate therapeutics cases occur when the plaintiff has "conferred non-pecuniary benefits on all the shareholders of the corporation, and the corporation, which is the alter ego of the shareholders, is obligated to pay the fee award."¹⁴³ In *Mills*, the Court awarded attorney's fees because the plaintiffs, who were shareholders of the defendant corporation, had proved a violation of the Securities and Exchange Act, which incurred a substantial benefit on the other shareholders.¹⁴⁴ Since the beneficiaries were shareholders of the defendant corporation, the Court imposed the attorney's fees on corporation effectively causing all shareholders to bear the legal expense of the prevailing party pro rata.¹⁴⁵

Union democracy cases occur when an individual union member successfully sues his union, conferring a benefit upon other union members as well as himself.¹⁴⁶ In *Hall v. Cole*, plaintiff was expelled from his labor union and sued to restore his membership.¹⁴⁷ The Court awarded plaintiff attorney's fees from the defendant labor union because the court's holding benefited union members generally and the defendant was an adequate representative of these workers' interests.¹⁴⁸

IV. THE AMERICAN RULE IN BANKRUPTCY

Although the American Rule plays a very minor role in bankruptcy generally, significant gaps and lacunae persist, and the Supreme Court's insistence that such gaps are by default governed by the American Rule has

¹⁴⁰*Schell v. OXY USA Inc.*, 814 F.3d 1107, 1126 (10th Cir. 2016).

¹⁴¹See DERFNER & WOLF, *supra* note 9, at ¶ 3.10-11.

¹⁴²11 U.S.C. §§ 503(b)(3)(A)-(E) (reimbursement of party) & 503(b)(4) (direct substantial contribution claim of attorney).

¹⁴³See DERFNER & WOLF, *supra* note 9, at ¶ 3.10 (citing *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 39-94, listing "corporate therapeutics" cases).

¹⁴⁴*Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 391-92 (1970).

¹⁴⁵*Id.*

¹⁴⁶See DERFNER & WOLF, *supra* note 9, at ¶ 3.11 for a list of "union democracy" cases.

¹⁴⁷*Hall v. Cole*, 412 U.S. 1, 3 (1973).

¹⁴⁸*Id.* at 13-14.

repeatedly led to problems. *Baker & Botts*, discussed briefly above, is one example, worthy of more in-depth examination.¹⁴⁹ The Supreme Court's reliance on the American Rule also creates unfortunate incentives in connection with claim objection practice as is made clear by the discussion of *Midland Funding* below.¹⁵⁰ A third example is the poor incentive structure created by the American Rule in preference law where most cases are determined conclusively on the basis of affirmative defenses but no mechanism exists for the unfortunate preference defendant to come out whole if it must incur legal fees to assert those defenses. These examples, while not exhaustive, illustrate that reflexive reliance on the American Rule as a default rule is a poor fit for bankruptcy litigation, leading to systemic problems which may be obviated or ameliorated through fee-shifting.

A. FEE OBJECTION LITIGATION.

*Baker & Botts*¹⁵¹ was counsel to ASARCO in its chapter 11 reorganization filed in 2005. The great value of the services it rendered and the strategic nature of the bitterly contested objection lodged against its fee application, are apparent from a brief review of the facts of the case.¹⁵² Unfortunately, overcoming that meritless objection cost *Baker & Botts* an additional \$5 million in legal fees that the Supreme Court found unrecoverable under the American Rule.¹⁵³

ASARCO mined and refined basic industrial commodities most importantly copper. Its crown jewel was its controlling interest in Southern Peru Copper Company (SPCC), a publicly traded Peruvian copper company. In late 1999, Grupo Mexico S.A.B. de C.V. (Grupo), a Mexican mining corporation, acquired ASARCO in a highly leveraged transaction for \$2 billion.¹⁵⁴

ASARCO had significant operating, liquidity, labor, asbestos, and environmental issues in addition to the acquisition-related debt it assumed in the Grupo transaction. By Fall 2001, ASARCO's financial difficulties became critical. In October 2001, ASARCO engaged Sidley Austin to provide bank-

¹⁴⁹See *infra* notes 151–165 and accompanying text.

¹⁵⁰*Midland Funding LLC v. Johnson*, 137 S. Ct. 1407 (2017), is discussed *infra* notes 186–203 and accompanying text. In a few jurisdictions, state laws providing for statutory reciprocal fee-shifting if contractual fee-shifting might have been available to one of the parties may provide some relief. *In re Andrade-Garcia*, 627 B.R. 158, 170–71 (Bankr. D. Nev. 2021).

¹⁵¹*Baker & Botts LLP and Jordan, Hyden, Womble, Culbreth & Holzer, PC* were co-counsel for the debtor in ASARCO and the fee application litigation discussed here involved both firms. *Baker & Botts LLP v. ASARCO LLC*, 576 U.S. 121, 124 (2015). For convenience sake, I refer to the petitioners collectively as “*Baker & Botts*.”

¹⁵²The background facts are drawn from the bankruptcy court's opinion in connection with the underlying fraudulent transfer matter. *ASARCO LLC v. Americas Mining Corp.*, 404 B.R. 150 (Bankr. S.D. Tex. 2009).

¹⁵³*Baker & Botts*, 576 U.S. at 125.

¹⁵⁴ASARCO, 404 B.R. at 155.

ruptcy and restructuring advice. In late 2001, Grupo loaned \$41.75 million to ASARCO to keep it afloat. Financial problems mounted throughout 2002. Toward the end of 2002, ASARCO's banks demanded repayment of its revolving credit line and threatened foreclosure (including foreclosure of its SPCC stock) if the debt was not paid. Moreover, \$100 million in public debt — the so-called “Yankee Bonds” — was coming due on February 3, 2003.¹⁵⁵

The insiders at Grupo and ASARCO “believed that ASARCO had only two feasible courses of action: bankruptcy or the sale of assets.”¹⁵⁶ ASARCO's most valuable and liquid asset was its SPCC stock. However, Grupo, being in the copper business itself, did not want to relinquish control of this valuable asset. Grupo decided ASARCO's restructuring would be premised on an intercompany sale of the SPCC stock to it rather than on an arms-length transaction.¹⁵⁷

The transaction closed on March 31, 2003. Despite some relief from its debt obligations as a result of the sale of the SPCC stock to Grupo, ASARCO remained in dire financial straits from 2003–2005. Cash flow problems increased, and asbestos-related and environmental liabilities mounted. ASARCO put a number of its subsidiaries into bankruptcy in early 2005, and filed its own Chapter 11 case on August 9, 2005.¹⁵⁸

On February 2, 2007, *Baker & Botts* filed suit on behalf of the ASARCO bankruptcy estate against Grupo alleging that the sale of ASARCO's SPCC stock to Grupo was an avoidable fraudulent transfer that had unlawfully depleted ASARCO's estate.¹⁵⁹ The estate ultimately obtained a judgment against Grupo worth between \$7 and \$10 billion, enabling a successful reorganization in which all of ASARCO's creditors were paid in full. After over four years in bankruptcy, ASARCO emerged in 2009 with \$1.4 billion in cash, little debt, and with its environmental liabilities resolved.¹⁶⁰

As part of this successful final resolution, however, New ASARCO remained a subsidiary of Grupo and emerged from bankruptcy under its control.¹⁶¹ Following consummation of the reorganization plan, *Baker & Botts* filed its final fee application seeking final allowance of compensation for its services to old ASARCO.¹⁶²

New ASARCO objected to allowance of *Baker & Botts*'s fee application. After extensive discovery and a six-day trial on fees, the bankruptcy court

¹⁵⁵*Id.*

¹⁵⁶*Id.* at 156.

¹⁵⁷*Id.* at 155–56.

¹⁵⁸*Id.* at 156.

¹⁵⁹11 U.S.C. § 544(b).

¹⁶⁰*Baker & Botts*, 576 U.S. at 124–25.

¹⁶¹ASARCO v. Americas Mining Corp., 404 B.R. 150, 155 (S.D. Tex. 2009).

¹⁶²*Baker & Botts*, 576 U.S. at 125.

rejected New ASARCO's objections and awarded Baker & Botts \$120 million for its work in the bankruptcy proceeding plus a \$4.1 million enhancement for exceptional performance.¹⁶³ The bankruptcy court also awarded over \$5 million in fees for time spent litigating in defense of the fee application.¹⁶⁴

The Supreme Court, rejecting statutory and policy arguments offered by the petitioner and various *amici* (including the Solicitor General),¹⁶⁵ reversed the \$5 million fee award relying on the American Rule.¹⁶⁶ It found no explicit statutory authority in the Bankruptcy Code supporting an award of attorney fees for Baker & Botts defense of its fee application even though the statute expressly authorized compensation for the cost of preparation of the fee application.¹⁶⁷

The Supreme Court's *Baker & Botts* decision is problematic on many fronts. Construing the Code to authorize the allowance of costs of preparing the fee application but not the costs of successfully defending to it is logically incoherent and ahistorical. It also leads to perverse incentives.

Outside of bankruptcy, in the course of collecting their fees, attorneys do not usually give notice to the world and then face objections to the fee's reasonableness from third parties. Prior to 1934 when corporate reorganizations were conducted through equity receiverships rather than statutory proceedings,¹⁶⁸ fee shifting was pervasive under the terms of negotiated plans,¹⁶⁹ but no fee application process or opportunity for third party objection to the

¹⁶³*Id.* at 125.

¹⁶⁴*Id.*

¹⁶⁵Brief Amicus Curiae of the United States, *Baker & Botts LLP v. ASARCO LLC*, U.S. Sup. Ct. Case No. 14-103 (filed Dec. 10, 2014). See also *supra* n.* (noting Baker & Botts *amicus curiae* brief filed by certain legal academics including the author of this Article).

¹⁶⁶*Baker & Botts*, 576 U.S. at 125.

¹⁶⁷*Id.* at 133-35.

¹⁶⁸Bankruptcy Act of 1898, § 12, 30 Stat. 544, 563 (1898) (repealed 1978); 6 COLLIER ON BANKRUPTCY ¶ [0.03] 21-28 (14th ed. 1978) (discussing limitations on bankruptcy compositions, including lack of provisions to address secured debt); see SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, Pt. I at 869 (1937) [hereinafter 1937 SEC REPORT] ("Prior to the enactment of Section 77 and Section 77B of the Bankruptcy Act, the favored method for effecting a corporate reorganization was through the federal consent receivership."); SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, Pt. VIII 250 at 61 (1940) [hereinafter 1940 SEC REPORT] ("Prior to the enactment of sections 77 and 77B, there was seldom resort to the provisions of the Bankruptcy Act for the purpose of effecting the reorganization of corporations whose securities were held by the general public. When such enterprises became involved in financial difficulties serious enough to entail judicial proceedings, they were customarily reorganized through the medium of equity receivership despite the disadvantages and limitations of that procedure. . .").

¹⁶⁹See *United States v. Chicago, M., St. P. & P.R. Co.*, 282 U.S. 311, 319-20 (1931) (describing equity receivership plan compensation provisions for multiple committees of creditors, stockholders and managers).

reasonableness of the shifted fees existed.¹⁷⁰ Neither fee application preparation nor defense was an issue in the usual non-bankruptcy case or in equity receivership practice.

In 1934, however, the enactment of section 77B brought reorganization law out of the world of equity receivership and into the Bankruptcy Act. Committees and interested parties could no longer set and recover their own fees by private agreements or plan provisions.¹⁷¹ Rather the supervising court was given authority to allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the proceeding and the plan by "officers, parties in interest, depositaries, reorganization managers and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing and of the debtor."¹⁷²

And so the fee application was born.

Under section 77B, courts applied strict standards to fee allowances which were perceived to impede the functioning of the reorganization. Even when courts found their services to be beneficial, attorneys still received below market fee allowances under the "conservation of the estate" principle.¹⁷³ The Supreme Court held that the statutes authorizing allowance of fees and expenses in bankruptcy cases under section 77B were to be strictly construed and might be limited to amounts "materially less than that which otherwise might have been considered reasonable."¹⁷⁴

The Chandler Act enacted Chapter X as the successor to section 77B.¹⁷⁵ Legislating on the basis of the SEC Reports and with SEC advice, Congress addressed perceived problems under prior reorganization law by providing that disinterested trustees would displace management in large cases, restricting the role of multiple committees of creditors, and directing courts to rely on expert assistance from the SEC, including SEC recommendations on professional fees. The Chandler Act included a detailed and comprehensive scheme for the supervision and allowance of reorganization fees and expenses.

¹⁷⁰6 COLLIER ON BANKRUPTCY ¶ 0.04[2.3] 58 (14th ed. 1978) ("[T]he receivership mechanism afforded only a perfunctory examination on the fairness of the essential phases of the proposed plan, since the theory was that the court could not control the plan. . . [and] [t]he receivership itself was costly and wasteful."); *Chicago, M., St. P. & P.R. Co.*, 282 U.S. at 324-28 (holding that the power to regulate commerce does not authorize regulation of equity receivership plan compensation provisions).

¹⁷¹6A COLLIER ON BANKRUPTCY ¶ 13.01 514 (14th ed. 1986).

¹⁷²11 U.S.C. § 207(c)(9); see also *In re Paramount Publix Corp.*, 83 F.2d 406, 407 (2d Cir. 1936) (discussing this provision).

¹⁷³*In re Paramount Publix Corp.*, 83 F.2d at 516-17; Emmett McCaffery, *Corporate Reorganization Under the Chandler Bankruptcy Act*, 26 CALIF. L. REV. 643, 657-58 (1938); Alfred B. Teton, *Reorganization Revised*, 48 YALE L.J. 573, 603-04, 606 (1939); 1940 SEC REPORT *supra* note 168; 6A COLLIER ON BANKRUPTCY ¶ 13.02 542 n.45 (14th ed. 1977).

¹⁷⁴*Callaghan v. Reconstr. Fin. Corp.*, 297 U.S. 464, 468 (1936).

¹⁷⁵Bankruptcy Act of 1938, Pub. L. 75-696, 52 Stat. 840 (1938).

Fee authorization was expanded and "democratized" to encourage participation by individuals and independent committees, but judicial control was strengthened. The principle of economy remained in effect under the Chandler Act and was further codified in the Federal Rules of Bankruptcy Procedure.¹⁷⁶ Courts continued to systematically impose below-market fees on bankruptcy professionals under Chapter X.¹⁷⁷

Preparing a fee application seemed analogous to the rendering of the invoice to the client and Chapter X courts generally refused to allow attorneys to recover that cost, noting the principle of economy.¹⁷⁸ But courts also saw no non-bankruptcy analog to fighting off third party objections to fee allowance. Hence, these same courts exercised discretion to allow the professional to recover the extraordinary costs associated with successfully litigating objections from parties in interest to the bankruptcy, the spirit of economy notwithstanding.¹⁷⁹ As one court put it, the pre-Code rationale behind denying fees for preparing fee applications did not "apply to services and expenses in connection with the successful defense, on appeal by others, of an award made to the applicant by the fee tribunals. In such case we think equitable considerations justify the awarding of compensation for the services required to defend the initial allowance."¹⁸⁰

¹⁷⁶FED. R. BANKR. P. 219(c) (repealed); FED. R. BANKR. P. 10-215 (repealed).

¹⁷⁷6A COLLIER ON BANKRUPTCY ¶ 13.02 537, 539-40 n.37 (14th ed. 1977); *Mass. Mutual Life Ins. Co. v. Brock*, 405 F.2d 429, 432 (5th Cir. 1968) (remanding fee awards because the trial court failed to consider "the public interest which is inherent in bankruptcy matters," even though it had properly considered the time spent on the case by the trustee and his counsel, the complexity of the issues, and the commendable results achieved); *Greensfelder v. St. Louis Public Serv. Co.*, 114 F.2d 53, 61 (8th Cir. 1940); *Milbank, Tweed & Hope v. McCue*, 111 F.2d 100, 101 (4th Cir. 1940); *In re Mt. Forest Fur Farms of Am.*, 157 F.2d 640, 647 (6th Cir. 1946); *Stark v. Woods Bros. Corp.*, 109 F.2d 969, 973-74 (8th Cir. 1940); *In re Standard Gas & Elec. Co.*, 106 F.2d 215, 216-17 (3d Cir. 1939); *Official Creditors' Comm. of Fox Markets, Inc. v. Ely*, 337 F.2d 461, 466 (9th Cir. 1964) (benchmarking fee allowances against judicial salaries rather than market rates); *In re York Int'l Bldg., Inc.*, 527 F.2d 1061, 1073 (9th Cir. 1975) (same); *In re Beverly Crest Convalescent Hosp., Inc.*, 548 F.2d 817 (9th Cir. 1976) (same).

¹⁷⁸*United Corp.*, 39 S.E.C. 391, 0059, WL 59228, at *5 (Sept. 30, 1954) (citing *Standard Gas & Elec. Co. v. S.E.C.*, 212 F.2d 407, 413 (8th Cir. 1954)); *In re Yale Exp. Sys., Inc.*, 366 F. Supp. 1376, 1386 (S.D.N.Y. 1973). In fact of course submitting a fee application for US Trustee and bankruptcy court review compliant with all the applicable statutes, rules and guidelines governing allowance of fees in bankruptcy is substantially more onerous than privately billing even the most demanding client for services rendered. See *supra* notes 173-177 and accompanying text.

¹⁷⁹See *In re Ark. Fuel Oil Corp. & Cities Serv. Co.*, 234 F. Supp. 31, 39-40 (D. Del. 1964) (exercising discretion to deny fee litigation fees, noting "policy of the [SEC] to allow supplemental fees wherever applicants have prevailed in the reviewing court").

¹⁸⁰*United Corp.*, 39 S.E.C. 391, 0059, WL 59228, at *5 (Sept. 30, 1954). The more liberal attitudes towards "fees-on-fees" in bankruptcy stood in contrast to some jurisdictions' reluctance to interpret statutory or contractual fee-shifting to encompass "fees-on-fees" absent explicit statutory or contractual provisions permitting their recovery. See, e.g., *Jones v. Voskresenskaya*, 125 A.D.3d 532, 534 (N.Y. 1st Dept. 2015) (finding referee's decision denying "recovery of 'fees-on-fees'" to be appropriate because "the parties' agreement [did] not explicitly provide for such fees.") (New York law); *Batsidis v. Wattack Mgmt. Co., Inc.*, 126 A.D.3d 551, 553 (N.Y. 1st Dept. 2015) ("Because it is not 'unmistakably clear' from the parties'

In 1978, in enacting the present Bankruptcy Code, Congress rejected both the principle of economy and the historical antipathy to allowing costs of fee application preparation.¹⁸¹ Nothing in this liberalization of the rules governing fee recovery suggests that the Congress, by rejecting blanket disallowance of preparation costs, implicitly intended to overrule the preexisting practice of allowing fee application defense costs in the court's discretion.

In 1978, in enacting the current Bankruptcy Code, Congress set forth five factors for courts to use in fixing "reasonable compensation for actual, necessary services" performed by bankruptcy professionals: "the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title."¹⁸² Current law even more explicitly directs the court to fix compensation on the basis of current market rates.¹⁸³

Neither section 330 nor any other part of the Bankruptcy Code rejects or alters pre-Code law allowing professional fees incurred in the defense of fee application objections in appropriate circumstances. Final fee rulings on such objections are plainly "necessary services" as the allowance of fees must be made before all bankruptcy estate assets can be distributed to administrative and pre-petition claimants and the case can be closed.

Both the change in pre-Code practice for fee applications and the lack of change in authorizing the award of fees in appropriate cases for defending fee challenges are informed by Congress's expressed intention that supervising courts consider the cost of comparable services in non-bankruptcy cases in allowing compensation.¹⁸⁴ The requirement to consider fees paid to other,

agreement that fees on fees were contemplated, such an award is not allowed.") (New York law). But see *Northeastern Aviation Corp. v. Pasternack*, 221 A.3d 100 (Table) (Del. 2019), *affg*, 2018 WL 5895827, at *11 (Del. Ch. Ct. 2018) ("Had Northeastern desired to avoid payment of fees-on-fees, it could have tailored its indemnification provision to exclude such payments.") (Delaware law); *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) ("[W]ithout an award of attorneys' fees for the indemnification suit itself, indemnification [is] incomplete.") (Delaware law).

¹⁸¹In expressly authorizing allowance of fees incurred in preparing the fee applications necessary to meet the requirements of sections 330 and 331 and Federal Rule of Bankruptcy Procedure 2014, Congress was careful, however, to impose a condition on this new authority to compensate for the preparation of fee applications. 11 U.S.C. § 330(a)(6). Any fee award for such services must be based on the level and skill reasonably required for the application. *Id.* Congress recognized that paralegals and junior attorneys, not high-billing senior partners, should provide the bulk of the services associated with the administrative preparation and processing of a fee application, and appropriately limited compensation for this routine, although time-consuming, task. Fee defense, unlike preparation of a fee application, however, is not a routine task. It can, as in *Baker & Botts*, involve complex, hotly contested adversary litigation and no special rule limits reasonable compensation to lower-billing professionals in such matters.

¹⁸²Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549 (quoting § 330 as originally enacted).

¹⁸³Section 330(a)(3)(F) as amended by the Bankruptcy Reform Act of 1994 § 224(b), Pub. L. 103-394 (Oct. 22, 1994) now provides that in fixing compensation the court shall consider "whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title." 11 U.S.C. § 330(a)(3)(F).

¹⁸⁴See H.R. REP. NO. 595, at 329-30 (1978), as reprinted in 1978 U.S.C.A.N. 5963, 6286 (expres-

non-bankruptcy professionals was added to implement the "policy of this section . . . to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under title 11."¹⁸⁵

Notwithstanding, all these factors, the *Baker & Botts* court, claiming to employ "textualism," disparaged any considerations beyond the text of section 330 as to the allowance of defense costs. It wrote:

"Our unwillingness to soften the import of Congress' chosen words even if we believe the words lead to a harsh outcome is long-standing," and that is no less true in bankruptcy than it is elsewhere. Whether or not the Government's theory is desirable as a matter of policy, Congress has not granted us "roving authority . . . to allow counsel fees . . . whenever [we] might deem them warranted." Our job is to follow the text even if doing so will supposedly "undercut a basic objective of the statute." Section 330(a)(1) itself does not authorize the award of fees for defending a fee application, and that is the end of the matter.¹⁸⁶

Despite this textualist rhetoric, *Baker & Botts* does not merely defer to a poor policy choice made by Congress and expressly embodied in the statutory text. The text at issue is *silent* on the question of fee application defense; there is no textual indication of an intent to override pre-Code practice allowing defense costs. Rather the Court *infers* that Congress created a sense-

sing intent to overrule cases setting arbitrary limits on fees and noting without fee parity, "[b]ankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously, would be driven elsewhere, and the bankruptcy field would be occupied by those who could not find other work and those who practice bankruptcy law only occasionally almost as a public service."); 124 CONG. REC. H11,091-92 (daily ed. Sept. 28, 1978) "[n]otions of economy of the estate in fixing fees are outdated and have no place in a bankruptcy code . . . bankruptcy legal services are entitled to command the same competency of counsel as other cases").

¹⁸⁵124 CONG. REC. H11,091-92 (daily ed. Sept. 28, 1978); 124 CONG. REC. S17,408 (daily ed. Oct. 6, 1978).

¹⁸⁶*Baker & Botts LLP v. ASARCO LLC*, 576 U.S. 121, 134-35 (2015) (citations omitted). Because the American Rule is generally viewed as a default rule that may be varied by contract the door would seem open to express contractual authorization of the professional's reasonable fee application defense costs in its engagement letter. Bruce A. Markell, *Loser's Lament: Caulkett and ASARCO*, 35 BANKR. L. LETTER (No. 8), Aug. 2015, at 8; Michael L. Cook, *Update on Bankruptcy Fee Shifting*, 33 THE BANKRUPTCY STRATEGIST (No. 3), Jan. 2016, at 2.

The lower courts, however, have refused to permit this work-around. *In re Boomerang Tube, Inc.*, 548 B.R. 69, 71 (Bankr. D. Del. 2016). *But see In re Nortel Networks Inc.*, No. 09-10138 (KG), 2017 WL 932947, at *8-9 (Bankr. D. Del. Mar. 8, 2017) (distinguishing *Boomerang* in enforcing provisions in bond indenture providing for recovery of fee application defense costs).

less distinction between preparation and defense costs based on an atextual default rule born of federal common law, the American Rule.

The Court attempted to conjure a rationale supporting the desired distinction between fee application preparation and defense costs. It analogized bankruptcy professionals' position as fee applicant to that of a car mechanic rendering an itemized bill. It asserted that the mechanic's invoice would itself be a compensable item of service to the customer but his collection costs would not be. But the Court's analogy to a car mechanic is a garbled mess.¹⁸⁷ I don't know what car mechanic the Court uses, but my mechanic's cost of bill preparation does not appear on the itemized invoices I receive as a separately billed item alongside the cost of parts and service for lubrication, oil change, filters, waste disposal fees and taxes. And those same invoices invariably provide, in standardized terms on the reverse, for costs of collection including reasonable attorney's fees in the event of dispute. Historically, lower courts' attempts to analogize fee application preparation and defense to the rendering and collection of non-bankruptcy invoices for services led to precisely the opposite conclusion than the one reached by the Court: Disallowance of the cost of preparation of the application, but compensation for its successful defense.

Leaving to the side the false factual predicate of the Court's analogy, the analogy is in any event a poor one. The process of defending a fee application in a collective proceeding over the objections of an adverse party is nothing like a mechanic collecting a disputed bill from the client who received the services. The analogy relied upon by the Court is the same one rejected by Congress when it abrogated pre-Code law denying compensation for fee application preparation. The entire thrust of Congress's 1978 revision of the fee allowance provisions in bankruptcy was to liberalize the allowance of professional fees in order to attract the highest quality counsel into bankruptcy practice. In allowing preparation costs it eliminated the "spirit of economy" principles previously grafted onto the process and expressly provided for compensation at full market rates. Interpreting the resulting statute to implicitly overrule a preexisting judicial practice of permitting recovery of defense costs to provide full compensation to the professional forced to defend its fees in litigation is simply perverse.

But even more perverse is the absurdity and waste inherent in easing the path for Grupo to avenge its loss in the fraudulent transfer litigation by im-

¹⁸⁷*Baker & Botts*, 576 U.S., at 132. The Court also had to distinguish its own prior statement in *Commissioner v. Jean*, 496 U.S. 154, 162 (1990) that it found "no textual or logical argument for treating so differently a party's preparation of a fee application and its ensuing efforts to support that same application." Although the language of the relevant statute in *Jean* differed from section 330 of the Bankruptcy Code, the Court's recognition that no logical argument supported the distinction in *Jean* is equally true in *Baker & Botts*.

posing a \$5 million cost on opposing counsel in collecting its fee for successfully establishing liability against it. Vindictive fee objection litigation by non-client parties is hardly something that the Congress or the courts should encourage. And yet after *Baker & Botts* a well-funded adversary can exploit the fee application process in just this way, even if it is unable to establish any meritorious objection.

B. TIME-BARRED CLAIMS.

A second example of the perversity of reliance on the American Rule in bankruptcy comes from the consumer debt area rather than large chapter 11 reorganization cases.

In *Midland Funding*,¹⁸⁸ the Supreme Court rejected a Fair Debt Collection Practices Act (FDCPA)¹⁸⁹ claim against a consumer debt collector whose business model involved the knowing assertion of time-barred claims purchased in bulk for pennies on the dollar.

Consumer debt collectors like Midland Funding buy debt from banks and other institutional consumer lenders in bulk at a steep discount. The Federal Trade Commission studied nine of the largest debt buyers who collectively bought 76.1 percent of the defaulted consumer debt sold in 2008, reviewing data on more than 5,000 portfolios containing nearly ninety million consumer accounts purchased during the three-year study period.¹⁹⁰ The average price was 4.0 cents per dollar of debt face value.¹⁹¹ The price for older debts was significantly lower than average, particularly for older debts likely to be time-barred—debt buyers paid on average 3.1 cents on the dollar for debts that were three to six years old and 2.2 cents per dollar of debt for debts that were six to fifteen years old compared to 7.9 cents per dollar for debts less than three years old.¹⁹² Debt collectors necessarily take into account the timeliness of the claims purchased not only to properly price the portfolio, but also to comply with the FDCPA's prohibition on asserting stale claims in state courts.¹⁹³

¹⁸⁸*Midland Funding LLC v. Johnson*, 137 S.Ct. 1407 (2017).

¹⁸⁹15 U.S.C. § 1692.

¹⁹⁰FEDERAL TRADE COMMISSION, THE STRUCTURES AND PRACTICES OF THE DEBT BUYING INDUSTRY at i-ii (Jan. 2013) [hereinafter FTC REPORT].

¹⁹¹*Id.*

¹⁹²*See Id.* at 23–24.

¹⁹³Court decisions find that the knowing assertion of time-barred claims in ordinary civil litigation violates the FDCPA's prohibitions on unfair and deceptive debt collection practices. 15 U.S.C. §§ 1692d–g; *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987); *see also Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013) (holding as much); *Huertas v. Galaxy Asset Mgmt.*, 641 F.3d 28, 32–33 (3d Cir. 2011) (indicating as much); *Castro v. Collecto, Inc.*, 634 F.3d 779, 783 (5th Cir. 2011) (same). The Consumer Financial Protection Bureau has reached a similar conclusion promulgating rules scheduled to go into effect November 30, 2021. *See Debt Collection Practices (Regulation F)*, 85 FED. REG. 76,734, 76,735 (Nov. 30, 2020) (to be codified at 12 C.F.R. § 1006.26(b)). Unfortunately, in

Some debt buyers specialize in debts of consumers who have filed for bankruptcy.¹⁹⁴ These portfolios represent millions of individual accounts and billions of dollars of consumer debt.¹⁹⁵ Bankruptcy judges described the flood of stale claims filed by professional debt collectors as a “plague” and “a new development that presents a challenge for the bankruptcy system.”¹⁹⁶

Why knowingly buy and assert millions of time-barred bankruptcy claims? The success of these debt collectors' business model depends on the ease of filing bankruptcy claims, the cost to objectors of asserting even the clearest statute of limitations defense, and the diffuse nature of the “tax” these stale claims impose on the bankruptcy system if they are allowed. The effect of not objecting to a stale claim is to dilute recoveries across the whole class of unsecured creditors. The business model depends on transferring value away from other creditors in a broad pro rata manner that leaves no individual creditor with any financial incentive to file objections. That transfer also indirectly and adversely affects consumer debtors whenever they do not receive a discharge (as in the majority of Chapter 13 cases)¹⁹⁷ or, like millions of Americans, have nondischargeable debts such as educational loans,

deference to the Supreme Court's *Midland Funding* decision bankruptcy claim filing is excepted from the scope of this rule. Some courts have held that even the assertion of time-barred claims outside of litigation violates the FDCPA. *Stepney v. Outsourcing Solutions, Inc.*, 1997 WL 722972, at *5 (N.D. Ill. 1997) (any collection on time-barred accounts violates the FDCPA); *Taylor v. Unifund*, 1999 WL 33541932 (N.D. Ill. 1999). Other courts find that absent litigation there is no FDCPA violation in asserting stale claims. *Freyermuth v. Credit Bureau Serv., Inc.*, 248 F.3d 767, 771 (8th Cir. 2001) (“[I]n the absence of a threat of litigation or actual litigation, no violation of the FDCPA has occurred when a debt collector attempts to collect on a potentially time-barred debt that is otherwise valid.”); *Shorty v. Capital One Bank*, 90 F. Supp.2d 1330, 1332 (D. N.M. 2000) (same); *Walker v. Cash Flow Consultants, Inc.*, 200 F.R.D. 613, 616 (N.D. Ill. 2001) (same).

¹⁹⁴The FTC REPORT, *supra* note 190, describes several buyers for which “some or all of the portfolios they had purchased were comprised of debts of consumers who had filed for bankruptcy.” *Id.* at D-1.

¹⁹⁵*See id.* at D-3; *see also American InfoSource, AIS INSIGHT 2015 YEAR IN REVIEW* at 14–15 (debt buyers filed hundreds of thousands of proofs of claim asserting hundreds of millions of dollars of consumer indebtedness in 2015).

¹⁹⁶*E.g., In re Jenkins*, 456 B.R. 236, 239 n.2 (Bankr. E.D.N.C. 2011); *In re Andrews*, 394 B.R. 384, 387 (Bankr. E.D.N.C. 2008).

¹⁹⁷Discharge is withheld in most Chapter 13 cases until the debtor's five-year plan is fully performed. 11 U.S.C. §§ 1328(a)–(b). Upwards of two-thirds of confirmed chapter 13 plans are never completed. *See, e.g., Till v. SCS Credit Corp.*, 541 U.S. 465, 493 & 493 n.1 (2004) (Scalia, J., dissenting) (discussing how “Chapter 13 plans often fail” and citing studies suggesting failure rates of nearly 60%, rates that further increased after Congress made substantial amendments to Chapter 13 in 2005); Katherine Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 TEX. L. REV. 103, 111–12 (2011) (noting how “knowledge of outcomes of Chapter 13 can largely be reduced to one enduring fact: only one in three cases ends in a Chapter 13 discharge” and summarizing data that nearly 75% of the remaining cases result in no bankruptcy discharge under any chapter, leaving numerous debtors with no debt relief whatsoever and subject to renewed debt collection efforts). In limited circumstances, however, a hardship discharge may be granted to a Chapter 13 debtor who fails to complete his plan payments for reasons beyond his control. 11 U.S.C. § 1328(b).

domestic support obligations, or certain tax debts.¹⁹⁸ In these cases, all amounts paid on a time-barred debt reduce what gets paid on other debts, which in turn increases the nondischargeable obligations the consumer continues to owe after the bankruptcy case. But consumer debtors are ill-equipped to undertake the legal analysis of the applicable statute of limitations, appreciate the indirect harm they suffer through increased deficiencies on nondischargeable debts, or fund the cost of filing a legal objection. While in some cases chapter 7 bankruptcy trustees have undertaken objections to stale claims, the American Rule shifting the burden to the trustee results in little or no economic benefit to the estate when the legal cost of objection is netted against the pro rata amounts paid out on account of stale claims should they remain allowed. In short, the *Midland Funding* business model succeeds by exploiting the inertia and expense of the bankruptcy system, including the fact that under the American Rule, prevailing claim objectors must bear their own legal costs.

The FDCPA by reversing the American Rule and allowing the recovery of prevailing party legal fees provided a powerful remedy neutering this exploitive business model.¹⁹⁹ But in *Midland Funding* the Supreme Court found the FDCPA effectively preempted by the Bankruptcy Code's scheme for presumptively allowing claims based on the filing of a proof of claim subject to objection.²⁰⁰ The Court held:

The Bankruptcy Code, by way of contrast, creates and maintains what we have called the "delicate balance of a debtor's protections and obligations. . . . To find the Fair Debt Collection Practices Act applicable here would upset that "delicate balance." From a substantive perspective it would authorize a new significant bankruptcy-related remedy in the absence of language in the Code providing for it. Administratively, it would permit postbankruptcy litigation in an ordinary civil court concerning a creditor's state of mind—a matter often hard to determine. See 15 U.S.C. § 1692k(c) (safe harbor for any debt collector who "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error"). Procedurally, it would require creditors (who

¹⁹⁸11 U.S.C. § 523(a) (identifying 19 separate categories of debts excepted from discharge).

¹⁹⁹The remedial provisions of the FDCPA include actual and statutory damages and recovery of prevailing plaintiffs' attorney's fees. 15 U.S.C. § 1692l(a)(1)–(3). Prevailing defendants may also recover their attorney's fee if the FDCPA action is brought in bad faith. 15 U.S.C. § 1692l(a)(3).

²⁰⁰11 U.S.C. § 502(a).

assert a claim) to investigate the merits of an affirmative defense (typically the debtor's job to assert and prove) lest the creditor later be found to have known the claim was untimely. The upshot could well be added complexity, changes in settlement incentives, and a shift from the debtor to the creditor the obligation to investigate the staleness of a claim.²⁰¹

Unfortunately, as the bankruptcy courts recognized pre-*Midland Funding*, bankruptcy's "delicate balance" between debtors and creditors was demonstrably out-of-whack and exploited by the *Midland Funding* business model, creating an unjust windfall for entrepreneurs willing to buy up and assert clearly time-barred claims and dare the other interested parties to object, notwithstanding the disproportionate cost of doing so. The obvious fix post-*Midland Funding* is to locate within the "delicately balanced" bankruptcy process a discretion to assess prevailing party legal fees in claim objection litigation. Prevailing claimants under consumer contracts with attorney's fees clauses may tack bankruptcy-related attorney's fees on to their claims under Supreme Court precedent.²⁰² But except in a few Western jurisdictions, the prevailing objector is unlikely to have a reciprocal right.²⁰³ Only the background assumption that the American Rule requires the objector to bear its own legal fees sustains the exploitive *Midland Funding* business model and burdens the bankruptcy system with meritless claims. There should be no need to look outside bankruptcy policy itself to the FDCPA or any other federal regulatory statute to control this practice.

C. PREFERENCES.

Consumer debt collectors are not the only constituency that has learned to exploit the inertia and legal cost of the bankruptcy system in areas where prevailing party fee-shifting is not available. Bankruptcy trustees have also done so. Preference law in particular has come in for sharp criticism on this ground.²⁰⁴

²⁰¹*Midland Funding LLC v. Johnson*, 137 S. Ct. 1407, 1415 (2017) (internal citations omitted).

²⁰²*Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007). Consumer contracts generally allow prevailing party attorney's fees against the consumer debtor as costs of collection.

²⁰³Post-*Travelers*, courts have allowed prevailing debtors and their estates to recover reciprocal attorney's fees in accordance with CAL. CIV. CODE § 1717 and similar statutes in some circumstances. See *infra* notes 215–216, and accompanying text. One court recently shifted fees incurred by an objector to stale consumer debt claims based on a Nevada fee-shifting statute authorizing discretionary prevailing party recovery of attorney's fees in small claims litigation. *In re Andrade-Garcia*, 627 B.R. 158, 170–71 (Bankr. D. Nev. 2021) (relying on NEV. REV. STAT. 18.010(2)(b)).

²⁰⁴Brook E. Gotberg, *Conflicting Preferences in Business Bankruptcy: The Need for Different Rules in Different Chapters*, 100 IOWA L. REV. 51, 53–56 (2014); Daniel J. Bussel, *The Problem With Preferences*, 100 IOWA L. REV. BULL. 11 (2014); Thomas D. Goldberg, *Curbing Abusive Preference Actions: Rethinking*

Particularly with respect to trade creditors furnishing goods and services to the debtor in the immediate pre-bankruptcy period, a problem with preference law is that in too many cases it operates, often arbitrarily, to force settlements from diligent creditors based on the cost of litigation and potential liability for basically innocent conduct; settlements that, in the aggregate, do little to meaningfully help creditors generally, but simply enrich estate professionals. When preference targets are those receiving payments within ninety days of bankruptcy in respect of goods or services, redistributing those preference recoveries to unsecured creditors ratably seems like rearranging the deck chairs on the *Titanic*. Pursuing such creditors for disgorgement of pre-bankruptcy payments in respect of valid trade debts by fighting through a panoply of fact-intensive defenses may provide little benefit to anyone save the lawyers who bill the estate (or successor liquidating trust) for recovering those dollars and then redistributing what is left after payment of administrative expenses to modestly improve general creditor recoveries. This is as true in chapter 7 cases (where the deck chair rearranging is done after the ship has sunk to the bottom of the sea) as it is in chapter 11 cases (where the captain of the ship should be focused on mid-course corrections to avoid the looming iceberg, not deck chairs).

The extensive statutory safe-harbors for financial creditors only underscore the arbitrariness and unfairness of current preference law as applied to trade creditors receiving modest preferences.²⁰⁵ Wall Street has obtained a free pass to demand, accept and retain preferences when it comes to securities settlements, repurchase agreements, options and futures, and indeed apparently any other financial instrument at all that it chooses to label as a "swap agreement."²⁰⁶ No wonder preference law is unpopular within the general business community.²⁰⁷

Congress has recognized these problems with preference litigation in various ways—imposing and raising venue limitations and jurisdictional minimums,²⁰⁸ expanding defenses,²⁰⁹ requiring additional diligence prior to the

Claims on Behalf of Administratively Insolvent Estates, 23 AM. BANKR. INST. J. 14, 54 (2004) (criticizing non-insider preference litigation that does not materially benefit general creditors).

²⁰⁵See Stephen J. Lubben, *The Bankruptcy Code Without Safe Harbors*, 84 AM. BANKR. L.J. 123, 124 (2010); Charles W. Mooney, Jr., *The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When is Safe Too Safe?* 49 TEX. INT'L L.J. 245 (2014); Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539, 573 (2011).

²⁰⁶11 U.S.C. §§ 101(53B) ("swap agreement"), 546(e)-(g), (j) (2013); see *In re Nat'l Gas Distribs., LLC*, 556 F.3d 247, 253, 259 (4th Cir. 2009) (noting that "[w]ith the 2005 Amendments to the Bankruptcy Code, . . . Congress substantially expanded the protections it had given to financial derivatives participants and transactions by expanding the definition of 'swap participants' and 'swap agreements' that are exempted from the automatic stay and from trustees' avoidance powers.").

²⁰⁷Gotberg, *supra* note 204, at 53-56.

²⁰⁸The Small Business Reorganization Act of 2019, Pub. L. 116-54, 133 Stat. 1079 (2019) (codified at 11 U.S.C. §§ 1184-95) increased the minimum dollar threshold for a trustee to pursue preference recovery

filing of preference complaints.²¹⁰ The most direct way of making the target of a meritless preference attack whole, however, remains a prevailing party fee-shift, still unavailable based on the default assumption that the American Rule applies to avoiding power litigation.²¹¹

V. LESSONS FROM PENROD

No discussion of the experience of fee-shifting in bankruptcy would be complete without reference to a line of Ninth Circuit cases reconciling bankruptcy policy with fee-shifting principles under California Civil Code section 1717. The line starts with *In re Fobian*,²¹² moves to *Travelers*²¹³ and culminates in *In re Penrod*²¹⁴ and its progeny.

California Civil Code section 1717(a) provides:

ery in a district other than the one in which the defendant resides to \$25,000. 28 U.S.C. § 1409(b) (as amended 2019). Subsections 547(c)(8) & (9) also preclude recovery of very small preferences (\$600 in consumer cases and \$6425 in commercial cases). 11 U.S.C. § 547(c)(8) & (9).

²⁰⁹In addition to continually expanding the scope of safe harbors for certain financial instruments, see *supra* note 205, Congress in enacting the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. Law 109-8, 119 Stat. 23 (2005), expanded trade creditors' reclamation defense, see BUSSEL, SKEEL & HARNER, *supra* note 102, at 628-29 (Note on Reclamation), created a statutory administrative priority for certain trade claims incurred within twenty days of bankruptcy, 11 U.S.C. § 503(b)(9), and significantly expanded the most important of the statutory affirmative defenses the ordinary course defense, 11 U.S.C. § 547(c)(2) to protect transfers that were made in the ordinary course of business or in accordance with ordinary business terms. Under prior law, defendants had to establish both that the transfer was made in the ordinary course of business and that was made in accordance with ordinary business terms. See *In re Nat'l Gas Distribs.*, 346 B.R. 394 (Bankr. E.D.N.C. 2006); see also Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11*, 79 AM. BANKR. L.J. 603, 604-08 (2005).

²¹⁰The Small Business Reorganization Act of 2019, Pub. L. 116-54, 133 Stat. 1079 (2019) imposed an obligation on the trustee to exercise reasonable due diligence in considering whether or not to file a preference action, including "tak[ing] into account a party's known or reasonably knowable affirmative defenses . . ." before proceeding with a suit. § 547(b) (as amended 2019). In the past, trustees might file preference actions based on a prima facie showing of liability without investigating defenses, imposing significant litigation costs on defendants with clear, valid defenses.

²¹¹In *SIPC v. Bernard L. Madoff Inv. Sec. LLC*, 631 B.R. 1, 17 (Bankr. S.D.N.Y. 2021), the court exercised discretion, perhaps as kind of proxy for an award of prevailing party attorney's fees, awarded the prevailing trustee prejudgment interest on recovery of a fraudulent transfer writing:

Prejudgment interest is warranted in this instance. The Trustee is charged with collecting fictitious profits from net winners so that net losers in BLMIS's Ponzi scheme can be adequately compensated for their losses. He has spent approximately ten years prosecuting this case and cannot be made whole without an award of prejudgment interest. Moreover, he has spent time and energy having to defend against legal arguments that have already been decided in these SIPA cases. All of the Defendant's legal arguments in opposition to this summary judgment motion were previously decided and law of the case.

Id.

²¹²951 F.2d 1149 (9th Cir. 1991).

²¹³*Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007).

²¹⁴802 F.3d 1084 (9th Cir. 2015).

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

California's embrace of reciprocity as an additional basis to depart from the American Rule in contract litigation is a minority position, but it is a long-standing one²¹⁵ and it has influenced the law in a number of other states including Delaware, Montana, Oregon, Utah, and Washington.²¹⁶

In *In re Fobian*, a creditor successfully defeated the debtor's plan of reorganization and then sought to recover the attorney's fees incurred in that effort under the attorney's fee clause in its contract. The Ninth Circuit, however, held that because the issues in the litigation were solely bankruptcy issues the proceeding was not a traditional "action on a contract" within the meaning of section 1717.²¹⁷

In *Travelers*, an unsecured creditor incurred substantial post-bankruptcy fees protecting its contract claim against the debtor in bankruptcy. Citing *Fobian*, the Ninth Circuit denied the requested fees on the ground that "attorney fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'"²¹⁸ The Supreme Court, however, rejected the notion that anything in federal bankruptcy law limited the scope of fees recoverable under section 1717. If state law authorized recovery of attorney's fees, *Travelers'* claim for attorney's fees was allowable in bankruptcy as part of its

²¹⁵CALIFORNIA CIVIL CODE § 1717 was first enacted in 1968, but California case law was skeptical of unilateral attorney fee clauses even prior to the enactment of the statute. See *Ecco-Phoenix Elec. Corp. v. Howard J. White, Inc.*, 1 Cal. 3d 266, 272 (1969).

²¹⁶See MONT. CODE ANN. § 28-3-704; OR. REV. STAT. ANN. § 20.096; UTAH CODE ANN. § 78b-5-826; WASH. REV. CODE ANN. § 4.84.330; DEL. CODE ANN. Tit. 6, §§ 4344, 7613. Some states have interpreted statutes similar to CAL. CIV. CODE § 1717 narrowly to limit reciprocal fee-shifting based on the nature of the cause of action. See *Florida Hurricane Prot. & Awning v. Pastina*, 43 So.3d 893, 895 (Fla. App. 4th Dist. 2010) (reciprocal fees not available to prevailing consumer in a breach of contract action under FLA. STAT. § 57.105(7) because contract limited fee shifting to "collection action."). Nevada, apparently focusing on the particular problem the American Rule poses for those who wish to prosecute small claims, authorizes prevailing party fee shifting if less than \$20,000 is at issue. NEV. REV. STAT. 18.010(2)(a). Alaska, of course, more generally adopts the English Rule. See *supra* note 14.

²¹⁷*Fobian* asserted that "the applicability of the bankruptcy laws to particular contracts is not a question of the enforceability of a contract but rather involves a unique, separate area of federal law." *Fobian*, 951 F.2d at 1153 (quoting *Collingwood Grain, Inc. v. Coast Trading Co.* (In re *Coast Trading Co.*), 744 F.2d 686, 693 (9th Cir. 1984).

²¹⁸*Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 167 Fed. App'x 593, 594 (2006).

general unsecured claim, even if the fees were incurred solely in connection with litigating bankruptcy issues. Accordingly, the Court expressly overruled *Fobian*.²¹⁹

Travelers put increased pressure on the California courts' interpretation of the proper scope of section 1717 and in particular the meaning of the phrase "an action on the contract." In *In re SNTL Corp.*,²²⁰ the court, acknowledging the abrogation of *Fobian* by *Travelers*, found that a creditor successfully overcoming an objection to its claim by a bankruptcy trustee was entitled to assert the bankruptcy-related fees it incurred in establishing the validity of its claim in the claim objection proceeding in accordance with its contract and applicable California state law.²²¹

California has liberally construed "action on a contract" to authorize an award of reciprocal fees whenever the opposing party would have been entitled to attorney fees under the contract had it prevailed.²²² Nothing in California law limited recovery of fees in an "action on a contract" to issues of contract interpretation, California contract law, or other California state law, and the California courts have repeatedly awarded reciprocal fees on the basis of a successful legal and factual defenses to contract claims whether those defenses were legal or factual or based on federal or state law.²²³ So long as a dispute "involves" a contract, or "arises out of, is based upon, or relates to an

²¹⁹*Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 452 (2007). The *Fobian* rule was not generally the law outside the Ninth Circuit. See *In re United Merch. Mfrs., Inc.*, 674 F.2d 134, 137 (2d Cir. 1982) (finding that state law governed the enforceability of creditors prebankruptcy contractual right to attorney's fees and allowing fees regardless of whether they were incurred in state court litigation or in collecting the claim in bankruptcy court in Chapter XI proceedings under the 1898 Act); see also *In re Cont'l Vending Mach. Corp.*, 543 F.2d 986, 993 (2d Cir.1976) (recovery of costs claimed by creditor in Chapter X proceeding cognizable as contractual right even though not within the 1898 Act's compensation provisions).

²²⁰*In re SNTL Corp.*, 571 F.3d 826, 829 (9th Cir. 2009) (affirming bankruptcy appellate panel opinion entered below and reported at 380 B.R. 204 (9th Cir. BAP 2007) and expressly adopting that opinion-as the Ninth Circuit's own).

²²¹*In re SNTL Corp.*, 571 F.3d at 840-46.

²²²*Santis v. Goodin*, 17 Cal. 4th 599, 611 (1998); *In re Tobacco Cases I*, 193 Cal. App. 4th 1591, 1601 (2011) ("an action is 'on a contract' when a party seeks to enforce, or avoid enforcement of, the provisions of the contract"); see *Milman v. Shukhat*, 22 Cal. App. 4th 538, 545-46 (1994); *N. Assocs. v. Bell*, 184 Cal. App. 3d 860, 864 (1986); *Turner v. Schultz*, 175 Cal. App. 4th 974, 908-09 (2009); *Dell Merk, Inc. v. Franzia*, 132 Cal. App. 4th 443, 455 (2005).

²²³See, e.g., *FDIC v. Dintino*, 167 Cal. App. 4th 333, 357 (2008) (contract claim denied on basis of California's one form of action rule); *ABF Capital Corp. v. Grove Props. Co.*, 126 Cal. App. 4th 204, 209-211 (2005) (claim time-barred); *RTC Mortg. Trust v. Shlens*, 62 Cal. App. 4th 304, 327-28 (1998) (defense barred by federal *D'Oench, Duhme* doctrine and 18 U.S.C. § 1823(e)); *Weber v. Langholz*, 39 Cal. App. 4th 1578, 1585-86 (1995) (action to rescind loan under federal Truth in Lending Act); *Chinese Yellow Pages Co. v. Chinese Overseas Mktg. Serv. Corp.*, 170 Cal. App. 4th 868, 881-85 (2008) (fees incurred litigating federal bankruptcy issues recoverable under California state law); *Circle Star Center Assoc. v. Liberate Tech.*, 147 Cal.App.4th 1203, 1209 (2002) (same); see also *In re Am. Suzuki Motor Corp.*, 494 B.R. 466, 492-93 (Bankr. C.D. Cal. 2013) (awarding reciprocal fees based on federal bankruptcy defense to rejection damages claim); *Gens v. Wachovia Mortg. Corp.*, No. 10-CV-01073-LHK,

agreement by seeking to define or interpret its terms or to determine or enforce a party's rights or duties under the agreement," the dispute is an action "on a contract" for purposes of section 1717.²²⁴

In this legal landscape *Penrod* arose.

In 2005, Marlene Penrod purchased a 2005 Ford Taurus automobile, pursuant to a Retail Installment Sale Contract governed by California law. The price of the Taurus was \$25,600.²²⁵ Penrod made a small cash down payment and at the same time traded in her 1999 Ford Explorer.²²⁶ Although she owed over \$13,000 secured by a lien on the Explorer, Penrod received a credit of only \$6,000 for the trade-in.²²⁷ As a result, there was more than \$7,000 in "negative equity" with respect to the Explorer.²²⁸ The dealership paid off the outstanding balance owed on the Explorer, credited Ms. Penrod for its \$6,000 trade-in value and added approximately \$7,000 to the dealer-financed indebtedness secured by the new Taurus.²²⁹ The Sales Contract expressly obligated Penrod to pay AmeriCredit all principal (including the \$7,000 in negative equity), 20 percent interest and the lender's reasonable collection costs, including attorney's fees.²³⁰

Eighteen months later Penrod filed for chapter 13 bankruptcy relief.²³¹ In order to collect the debt owed under the Sale Contract, AmeriCredit filed a proof of claim with the bankruptcy court, attaching the Sale Contract as an exhibit, and asserting a fully secured claim in the aggregate amount of \$25,675.31 as of the petition date. Ms. Penrod filed and thereafter amended a chapter 13 plan providing she would retain her 2005 Taurus but pay AmeriCredit only \$18,537.89 plus interest out of her future earnings – not the full \$25,675.31 asserted in AmeriCredit's proof of claim, and that AmeriCredit's security interest in the Taurus would be limited to securing this portion of its total claim.²³² The plan provided that the difference, approximately \$7,000, be treated as an unsecured claim.²³³ Under the plan, the unsecured

2011 WL 3844083, at *1–2 (N.D. Cal. Aug. 30, 2011) (action asserting defenses to loan under federal Truth in Lending Act and other federal consumer protection statutes dismissed).

²²⁴*Douglas E. Barnhart, Inc. v. CMC Fabricators, Inc.*, 211 Cal.App.4th 230, 242 (2012); see also *In re Relativity Fashion, LLC*, 565 B.R. 50, 57 (Bankr. S.D.N.Y. 2017).

²²⁵*In re Penrod (Penrod I)*, 611 F.3d 1158, 1159 (9th Cir. 2010).

²²⁶*Id.* at 1159–60.

²²⁷*Id.* at 1160.

²²⁸*Id.*

²²⁹*Id.*

²³⁰The Sales Contract provided: "You [Penrod] may have to pay collection costs. You [Penrod] will pay our reasonable costs to collect what you [Penrod] owe, including attorney fees, court costs, collection agency fees, and fees paid for other reasonable collection efforts." *In re Penrod (Penrod II)*, 802 F.3d 1084, 1087 (9th Cir. 2015) (quoting contractual provision).

²³¹*Penrod I*, 611 F.3d at 1160.

²³²*In re Penrod*, 392 B.R. 835, 840 (9th Cir. BAP 2008).

²³³*Penrod II*, 802 F.3d at 1087.

claim would be payable on a pro rata basis with other unsecured claims, if, and only to the extent Ms. Penrod had available post-petition earnings after satisfying all other priority and secured claims described in the plan.²³⁴ The unpaid amount was discharged in 2012 when Penrod completed payments under her plan.

This treatment of AmeriCredit's contractual debt under the plan was based on Ms. Penrod's position that only the portion of AmeriCredit's claim attributable to the price of Ms. Penrod's 2005 Taurus constituted a purchase money security interest within the meaning of the California Commercial Code and the so-called hanging paragraph of Bankruptcy Code section 1325(a)*,²³⁵ and that the claim for \$7,000 in refinanced negative equity associated with her old Explorer was *not* purchase money. The "hanging paragraph" forbids bifurcation of a claim into secured and unsecured claims under a chapter 13 plan with respect to a car loan only to the extent that that debt is subject to a "purchase money security interest."

Four years of hotly contested appellate litigation in the bankruptcy appellate panel, Ninth Circuit and the Supreme Court ensued ultimately resulting in a judgment of the Ninth Circuit vindicating Penrod's legal position that she was entitled under bankruptcy law to strip down the contractual lien in her Ford Taurus to eliminate the refinanced negative equity associated with her trade-in vehicle.²³⁶

Penrod's appellate counsel then sought to recover almost \$245,000 in fees and costs incurred in the multiple appeals over the hanging paragraph asserting that the unilateral fee-shifting provision in the Sale Contract in favor of AmeriCredit was made reciprocal by California Civil Code section 1717 and the fees incurred in litigating her legal defenses to AmeriCredit's claimed lien based on the California Commercial Code and the section 1325(a)*. The Ninth Circuit agreed, finding that:

[T]he hanging-paragraph litigation was an "action on a contract" in which Penrod prevailed. The only remaining question is whether AmeriCredit would have been entitled to recover attorney's fees had it prevailed, a necessary prerequisite for Penrod to recover her own fees. We think the answer to that question is clear. The contract included—no doubt for AmeriCredit's benefit—an attorney's fees provi-

²³⁴*Id.* at 1086.

²³⁵11 U.S.C. § 1325(a)* is referred to as the "hanging paragraph" because of Congress's inadvertent failure to sequentially number the relevant paragraph of the 2005 BAPCPA amendment in the official codification of section 1325.

²³⁶AmeriCredit's subsequent petitions for rehearing *en banc* and *certiorari* were denied and the judgment became final. See 132 S. Ct. 108 (Oct. 3, 2011) (denying *certiorari*); 636 F.3d 1175 (9th Cir. 2011) (denying rehearing *en banc*).

sion quite broad in scope. The provision was not limited, for example, to actions to determine whether the terms of the contract had been breached. It instead stated that, in the event of default, Penrod would be obligated to pay the reasonable attorney's fees AmeriCredit incurred in attempting "to collect what you owe." That provision encompasses AmeriCredit's efforts in the hanging-paragraph litigation to establish that it held a fully secured rather than a partially secured claim. AmeriCredit wanted to prevail on that issue to ensure that it would collect 100 [percent] of what it was owed on the loan. AmeriCredit had no reason to litigate that issue other than as part of an attempt to collect from Penrod what she owed. . . . As the "party prevailing on the contract," Penrod is entitled to recover reasonable attorney's fees under § 1717.²³⁷

Following *Penrod II*, courts applying California law have struggled to define the scope of the bankruptcy litigation that falls within the "action on a contract" language of section 1717. In *Bos v. Board of Trustees*,²³⁸ the Ninth Circuit distinguished *Penrod* in a case involving the dischargeability of a claim against a bankrupt employer that had failed to honor a \$500,000 debt to its employees' pension fund embodied in a promissory note. The plan fiduciaries argued that the fund's undisputed claim on the promissory note debt was nondischargeable as "defalcation" by the bankrupt employer under section 523(a)(4).²³⁹ The bankruptcy court determined the debt could not be discharged and the district court affirmed.

On appeal to the Ninth Circuit, however, the court reversed and found the claim fell outside section 523(a)(4)'s exception to discharge, leaving the pension fund with only a dischargeable unsecured claim against the insolvent estate. The defaulting employer then sued to recover its attorney's fee relying on the attorney's fee clause in the promissory note, section 1717, and *Penrod*.

²³⁷*Penrod II*, 802 F.3d at 1089-90 (citation omitted). The Ninth Circuit did not address the asymmetry between the parties' financial condition that made the debtor's "reciprocal" right against the creditor much more valuable than the prevailing creditor's contractual right against her would have been. Had AmeriCredit prevailed before the Supreme Court in preventing the \$7000 strip down there was no conceivable way it could have recovered hundreds of thousands of dollars in legal fees from Marlene Penrod, and its claim to do so, had it been asserted would have been discharged under her chapter 13 plan as a prepetition unsecured claim. Penrod, however, as prevailing party could expect to recover her appellate attorney's fees in full from the solvent AmeriCredit. This is similar to the practical asymmetry that resulted from Florida's adoption of the English Rule in medical malpractice litigation. See *supra* notes 36-50, and accompanying text.

²³⁸818 F.3d 486 (9th Cir. 2016).

²³⁹11 U.S.C. § 523(a)(4) (excepting from discharge debts "for fraud or defalcation while acting in a fiduciary capacity").

The Ninth Circuit, probably taken by surprise that the employer was not content with merely prevailing and obtaining its discharge but now wanted to collect hundreds of thousands of dollars in fees from its employees' already underfunded pension plan, distinguished *Penrod*. It determined that nondischargeability actions in bankruptcy were not "actions on a contract" because neither the enforceability of the debt or its amount was at issue, only the proper scope of the debtor's discharge.²⁴⁰

One can sympathize with the result in *Bos*. It seems a bit much to stick the employees' pension fund not only with an uncollectible debt against the defaulting bankrupt employer but also with a bill for the employer's legal fees. But the attempt to distinguish *Penrod* and reconcile *Bos* with the cases liberally construing section 1717 seems forced. Discharge is a federal bankruptcy defense to liability on a debt. In a traditional state law contract suit it would be an affirmative defense to a suit on the promissory note.²⁴¹ If the question of the scope and applicability of the discharge were litigated in state court and the noteholder prevailed on the basis that the discharge did not apply in this case, surely its attorney's fees in doing so would be recoverable under the attorney's fee clause as construed in light of the applicable California caselaw. *Penrod* would seem to say that changing the venue from state court to bankruptcy court and flipping the lender from state law plaintiff in a lawsuit to bankruptcy defendant in an adversary proceeding shouldn't matter. If the claimant would have been able to recover its fees litigating the issues in state court had it prevailed, then the prevailing debtor in bankruptcy court should be entitled to do so also as a matter of reciprocal right under section 1717. There was no question in *Penrod* about the enforceability or validity of the debt, only the scope of the bankruptcy right of bifurcation under section 506 and the hanging paragraph of section 1325(a)*. It's unclear how limiting the claimant's collection rights via the defense of bifurcation is categorically different from doing so via discharge.

Following *Bos* some courts have nevertheless focused on trying to categorically distinguish actions by "kind" in order to define the proper scope of the reciprocal right under *Penrod*. Nondischargeability actions are not "actions on a contract"²⁴² but claim objections probably are.²⁴³ Plan confirma-

²⁴⁰*Bos*, 818 F.3d at 490.

²⁴¹The bankruptcy discharge of course is not merely a state court affirmative defense. It also operates as a federal injunction enforceable by the bankruptcy court. See, e.g., *In re Meadows*, 428 B.R. 894, 904-06 (Bankr. N.D. Ga. 2010). This fact does not, however, detract from the point in the text that in California state court contract litigation involving the issue, attorney's fees would be recoverable by the prevailing party under § 1717.

²⁴²*Bos*, 818 F.3d at 490; *In re Davison*, 289 B.R. 716, 723-24 (B.A.P. 9th Cir. 2003); *In re McClain*, No. 1:14-ap-01058-VK (Bankr. C.D. Cal. Oct. 5, 2016). But see *In re Baroff*, 105 F.3d 439, 443 (9th Cir. 1997) (debtor recovered attorney's fees after prevailing in non-dischargeability action properly character-

tion objections may be “actions on a contract,”²⁴⁴ but avoiding power litigation probably isn’t.²⁴⁵ Prevailing in a breach of contract claim permits fee recovery;²⁴⁶ prevailing on a fraud claim arising out of a contract does not.²⁴⁷ Fees for foreclosure actions can be recovered;²⁴⁸ but not for prevailing on a motion to lift the stay to foreclose.²⁴⁹ Litigating the debtor-tenant’s liability for a cure of default upon assumption of a real property lease will give rise to a claim for reciprocal attorney’s fees for the prevailing party, but other bankruptcy litigation impacting the landlord’s rights in the property occupied by the tenant will not.²⁵⁰ Analytically, the resulting caselaw is a mess, as this list, and the Ninth Circuit’s feeble effort to reconcile *Penrod* and *Bos* illustrates.

But interestingly, when one focuses on facts and equities rather than categories of proceedings and kinds of issues, not only can the cases be reconciled, they seem to coherently advance the just resolution of the matter before the court. Take the nondischargeability cases for example. Some nondischargeability actions are brought on flimsy bases by bullies against debtors (often unrepresented) who lack the resources to protect their legal right to a discharge. Shifting fees in favor of a prevailing debtor in such a case seems perfectly reasonable. *Bos*, however, is an entirely different kind of nondischargeability case. The pension fund in *Bos* had a credible enough claim to prevail on its nondischargeability claim at trial and on appeal and lost on a technical interpretation of the scope of the defalcation exception at the Ninth Circuit. Sticking the employee’s pension fund with a bill for the defaulting employer’s legal fees in that situation seems to add insult to injury.

Conversely, in *Penrod*, where the Ninth Circuit imposed reciprocal fee-shifting, the equities of the matter sharply favored the prevailing individual debtor Marlene Penrod. Penrod was a consumer, for whom \$7000 in refinanced debt on her trade-in vehicle was a significant obstacle to a successful chapter 13 reorganization. She was opposed by virtually the entire automo-

ized as “on the contract” because court needed to determine enforceability of contract (a pre-petition settlement agreement) to determine dischargeability).

²⁴³*In re Relativity Fashion, LLC*, 565 B.R. 50, 65 (Bankr. S.D.N.Y. 2017).

²⁴⁴*In re Penrod (Penrod II)*, 802 F.3d 1084, 1088 (9th Cir. 2015).

²⁴⁵*In re Mac-Go Corp.*, No. 14-44181, 2015 WL 1372717 (Bankr. N.D. Cal. Mar. 20, 2015) (secured lender could recover fees for contract based defense of preference and fraudulent transfer claims).

²⁴⁶*In re SNTL Corp.*, 571 F.3d 826 (9th Cir. 2009).

²⁴⁷*High Sierra Properties, Inc. v. Mitchell*, No. B280201, 2019 WL 1324398 (Cal. Ct. App. Mar. 25, 2019). *But see Santisas v. Goodin*, 17 Cal. 4th 599, 608-09 (1998) (attorney’s fee clause applied in actions “arising out of the execution” of the parties’ agreement and this phrasing is broad enough to support award of attorney’s fees to prevailing party alleging both contract and non-contract claims).

²⁴⁸*See, e.g., In re Hoopai*, 581 F.3d 1090, 1101-03 (9th Cir. 2009).

²⁴⁹*In re Menco Pac., Inc.*, No. LA CV17-07830 JAK, 2019 WL 653086 (C.D. Cal. Feb. 15, 2019).

²⁵⁰*In re Hawkeye Entertainment, LLC*, 625 B.R. 745, 761 (Bankr. C.D. Cal. 2021) (awarding prevailing debtor nearly \$606,000 in attorney’s fees in lease assumption litigation).

bile finance industry²⁵¹ which forced her to litigate through four successive courts over four years (with Penrod prevailing at every level) to establish her right to retain her car subject only to the purchase money portion of the debt. She thereby set a precedent benefiting consumer debtors in chapter 13 proceedings binding throughout the western United States. It would be difficult to imagine a more sympathetic case for prevailing party fee-shifting.

All this suggests that on the question of whether or not the prevailing party should recover bankruptcy-related attorney’s fees, we could do better trusting the intuitions and sense of the equities of the bankruptcy courts hearing the matters litigated to final judgment before them rather than relying on some *ex ante* rule or rigid set of categories of proceedings or issues in which, on average or in theory, fee-shifting is appropriate.

VI. MOVING TO A DISCRETIONARY PREVAILING PARTY REGIME FOR RECOVERY OF ATTORNEYS’ FEES

A. A MODIFIED ENGLISH RULE FOR BANKRUPTCY CASES.

It’s been a long-windup but it should be pretty clear where the pitch is headed by now. The thesis of this Article is that bankruptcy courts should be allowed to exercise a general discretionary authority to award prevailing party attorney’s fees in bankruptcy litigation. One can argue that the long established equitable exceptions to the American Rule based on “common fund” and “substantial benefit,” which are both rooted in ancient bankruptcy practice administered in English Chancery courts and 19th century federal courts sitting in equity and expanded from that source, provide an ample legal foundation for this power. No express federal statute sets out the American Rule as a general default principle—the American Rule is an artifact of pre-*Erie* federal common law.²⁵² Federal common law is not frozen forever in its

²⁵¹AmeriCredit Financial Services, Inc. is the finance arm of the General Motors Company. *Amici curiae* briefs supporting AmeriCredit were filed by the (i) American Bankers Association [Dkt. No. 5] (filed June 27, 2011), (ii) Ally Financial Inc. et al. [Dkt. No. 6] (filed June 27, 2011), and (iii) the American Financial Services Association, National Automobile Dealers Association and California Bankers Association, 2011 WL 2559137 [Dkt. No. 4] (filed June 24, 2011) in support of AmeriCredit’s petition for certiorari in the underlying *Penrod* litigation. The Ally Financial *amicus* brief was joined by American Suzuki Financial Services Co. LLC, Bank of America, N.A., Ford Motor Credit Co. LLC, JPMorgan Chase Bank, N.A., Nissan Motor Acceptance Corp. and Wells Fargo Bank, N.A. *See* 2011 WL 2559139. *See AmeriCredit Financial Services, Inc. v. Penrod*, Sup. Ct. No. 10-1443 (cert. petition filed May 25, 2011).

²⁵²At the same time it was recognizing equitable exceptions to the American Rule rooted in ancient insolvency cases, the Supreme Court construed the 1853 Fee Bill, 10 Stat. 161 (subsequently repealed) as codifying the American Rule. *See Stewart v. Sonneborn*, 98 U.S. 187, 197 (1879) (attorney’s fees unavailable in malicious prosecution action); *Flanders v. Tweed*, 82 U.S. (15 Wall.) 450, 452-53 (1872) (fee award unavailable in action to recover cotton illegally seized by United States); *Oelrichs v. Spain*, 82 U.S. (15 Wall.) 211, 230-31 (1872) (no fees in action to obtain damages based on security bond); *The Baltimore*, 75 U.S. (8 Wall.) 377, 392 (1869) (attorney’s fees not recoverable in admiralty action); *Teese v. Huntingdon*, 64 U.S. (23 How.) 2, 8 (1859) (attorney’s fee unavailable in suit for patent infringement). The United

pre-1937 state. Courts may evolve and adapt common law to better serve the society it regulates. It is a small leap in light of the history and practice of special treatment of attorney's fees in bankruptcy to find a discretionary fee-shifting power in the bankruptcy court. There has been resistance at the Supreme Court to evolving the American Rule notwithstanding its status as federal common law.²⁵³ The fact that long-standing equitable exceptions to the American Rule are grounded in a chain of bankruptcy precedents extending back centuries however provides a work-around: The Supreme Court's recognition that the Bankruptcy Code in general incorporates established pre-Code practices unless the text or context of the Code otherwise requires. This necessary discretion might be found in the interstices of the Bankruptcy Code by implication informed by pre-Code precedent and history rather than as an organic evolution of federal common law. Others may insist that an express amendment to the Bankruptcy Code or Federal Rule of Bankruptcy Procedure 7054(b)²⁵⁴ providing discretion to award prevailing party attorney's fees in bankruptcy litigation is necessary.

Assuming the authority exists or can be found, bankruptcy courts that recognize their discretion to permit prevailing parties in litigation before them to recover their attorney's fees will in particular circumstances find equitable and practical considerations bearing on that decision. It is impossible to anticipate or to assign fixed weight in advance to all potentially relevant factors that figure into the decision to award fees in a particular case. Nevertheless, it is possible to lay out in broad terms factors that should commonly be relevant in considering fee-shifting in favor of a prevailing party in

States Code as currently in force designates a list of generally recoverable "costs," 28 U.S.C. §§ 1920, 1923, but makes no specific mention of attorney's fees among them.

²⁵³Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 270-71 (1975) ("[T]he [American R]ule followed in our courts with respect to attorney's fees has survived. It is deeply rooted in our history and in congressional policy; and it is not for us to invade the legislature's province by redistributing litigation costs in the manner suggested by respondents and followed by the Court of Appeals.").

²⁵⁴FED. R. BANKR. P. 7054 currently provides:

(a) *Judgments.* Rule 54(a)-(c) F.R.Civ.P. applies in adversary proceedings.

(b) *Costs; Attorney's Fees.*

(1) *Costs Other Than Attorney's Fees.* The court may allow costs to the prevailing party except when a statute of the United States or these rules otherwise provides. Costs against the United States, its officers and agencies shall be imposed only to the extent permitted by law. Costs may be taxed by the clerk on 14 days' notice; on motion served within seven days thereafter, the action of the clerk may be reviewed by the court.

(2) *Attorney's Fees.*

(A) Rule 54(d)(2)(A)-(C) and (E) F.R.Civ.P. applies in adversary proceedings except for the reference in Rule 54(d)(2)(C) to Rule 78.

(B) By local rule, the court may establish special procedures to resolve fee-related issues without extensive evidentiary hearings.

bankruptcy litigation.²⁵⁵

1. Whether the prevailing party or its adversary has a right to recover fees in non-bankruptcy litigation over the same issues.²⁵⁶

2. Whether the Bankruptcy Code expressly provides for recovery of attorney's fees.²⁵⁷

3. The amount of the fees sought to be shifted and whether the litigation is cost justified in light of the stakes.²⁵⁸

4. How close the case was on the merits as to the issues upon which the prevailing party seeks fees. As the merits case for the prevailing party becomes stronger the case for fee-shifting does as well. The English Rule is widely thought to encourage the prosecution of meritorious claims of all sizes and the moral case for augmenting the recovery of the holder of a meritorious claim by an award of attorney's fees increases in proportion to the strength of that claim.

5. Whether the circumstances of the case and the actions of the non-prevailing party suggest its litigation position was a tactic by which it played the part of bully, hold-out, or squeaky wheel, litigating to gain leverage to extract concessions or advantages they are not entitled to or that others similarly situated eschewed.²⁵⁹

6. Whether a systemic asymmetry exists between the parties allowing one party to implicitly shift fees whether it prevails or not and regardless of the court's fee award. Systemic asymmetries of this nature abound in bankruptcy.²⁶⁰ As noted in the preference discussion,²⁶¹ win or lose, litigants represented by estate professionals can effectively shift fees to the extent the

²⁵⁵Fee-shifting borne by the bankruptcy estate as part of the equitable allocation of the costs of litigation may have materially different effects than contractual fee-shifting under *Travelers*, *supra* notes 213-219, and its progeny. Fee-shifting under those authorities only enhances the prevailing creditor's pre-bankruptcy claim against the estate whereas an award of costs against the estate as part of the resolution of post-petition litigation creates an administrative liability entitled to priority that must be paid in full in cash on the effective date of any plan of reorganization. 11 U.S.C. §§ 507(a)(2), 1129(a)(9)(A).

²⁵⁶Non-bankruptcy entitlements generally form a baseline for litigants' rights in bankruptcy. *Travelers* Cas. & Sur. Co. v. Pac. Gas & Elec. Co., 549 U.S. 443 (2007); *Butner v. United States*, 440 U.S. 48 (1979).

²⁵⁷11 U.S.C. §§ 105(a) (orders in aid of jurisdiction), 110(i) (recovery of debtor's counsel fees from paid petition preparers), 303(i) (damages from dismissed involuntary petition), 362(k) (damages from violation of automatic stay, 524 (discharge injunction). *But see* Taggart v. Lorenzen, 139 S.Ct. 1795 (2019) (imposing civil contempt standard of "no objectively reasonable basis for concluding that the creditor's conduct might be lawful" on discharge violation sanctions). *See also* FED. R. BANKR. P. 9011. Bankruptcy courts also commonly invoke their "inherent powers" to award compensatory sanctions for litigant or professional misconduct in the form of granting or denying compensation for attorney fees; *see, e.g.* *In re Dyer*, 322 F.3d 1178, 1187 (9th Cir. 2003).

²⁵⁸*Cf.* ALASKA R. Civ. P. 82(b)(3).

²⁵⁹*See supra* notes 186-203 and accompanying text (discussing *Midland Funding*).

²⁶⁰*See supra* notes 92-104 and accompanying text (bullet points noting various fee shifting opportunities in bankruptcy).

²⁶¹*See supra* notes 204-210 and accompanying text (trustees' incentives to bring preference actions at estate expense).

estate is administratively solvent. When such parties prevail, the case for further fee-shifting weakens. On the other hand, if the losing party can effectively fee-shift regardless of its loss the case for allowing the prevailing party to also force the estate to pay its reasonable legal fees strengthens. An asymmetry also exists in reciprocal fee shifting if one of the parties is execution proof or if the claim for recovery of the attorney's fees is treated as a dischargeable general unsecured claim against an insolvent bankruptcy estate.²⁶²

7. Whether the prevailing party's success in litigation will economically benefit others similarly situated or creditors generally or other constituents interested in the bankruptcy case either by maximizing the value of the estate or altering the distribution of value in a manner that benefits creditors generally or other constituents similarly situated to the prevailing party, especially to the extent such situations fit comfortably within the traditional common fund and substantial benefit exceptions to the American Rule.²⁶³

8. Whether the public interest in equitable and efficient administration of bankruptcy cases generally will be advanced or undermined by an award of fees in these circumstances.²⁶⁴

9. The extent to which a given fee award may be so onerous to the non-prevailing party that it would unreasonably deter similarly situated litigants from the voluntary use of the bankruptcy courts.²⁶⁵ The threat of a fee award against an objecting party in the context of a confirmation hearing is particularly problematic on this basis. A confirmation objector will generally face an array of well-represented and well-funded parties who have closed ranks behind the plan. The expenses of the confirmation hearing are likely to be grossly disproportionate to the claim of an isolated objecting party. Moreover, the "confirmation express" dynamic may mean that even an objector with a good objection faces long-odds of prevailing at confirmation. In that context, the threat of an award of prevailing party fees may well be a bullying tactic employed by the plan proponents against the objector.

10. Vexatious and unreasonable conduct by either (or both) of the litigants in the course of the proceedings conducted before the bankruptcy.²⁶⁶

²⁶²See *supra* notes 36–50 and accompanying text (discussing Florida malpractice experiment with the English Rule) & *supra* note 237 (discussing Ms. Penrod's inability to satisfy any claim for attorney's fees had AmeriCredit prevailed). Interestingly, Delaware prohibits fee-shifting provisions in corporate charters or bylaws. Del. Gen. Corp. L. § 109(b). Shareholders' litigation against their own corporation may be one area where prevailing party fee-shifting would operate systematically in favor of the corporation to deter shareholder suits.

²⁶³11 U.S.C. § 503(b)(3), (4) (administrative expense claims in of parties and their attorneys "substantial contribution" to the case); see *supra* notes 113–148 and accompanying text (discussing common fund and substantial benefit equitable exceptions to the American Rule).

²⁶⁴See *supra* notes 186–203 and accompanying text (discussing *Midland Funding*).

²⁶⁵Cf. ALASKA R. CIV. P. 82(b)(3)(I).

²⁶⁶Cf. ALASKA R. CIV. P. 82(b)(3)(G). See *supra* notes 151–165 and accompanying text (discussing *Baker & Botts*).

11. The extent to which the fees incurred by the prevailing party suggest that they had been influenced by considerations apart from the case at bar because of its status as a repeat player in bankruptcy. Parties that bring litigation that would not otherwise be brought to set a precedent or build a reputation should bear the cost of doing so even when they prevail. Parties facing such a litigant may have a particularly strong equitable case for fee shifting if they defeat the repeat player.²⁶⁷

12. The extent to which the party seeking recovery of fees practically prevailed in the litigation by comparing the result relative to the parties' contending litigation positions. Courts administering the English Rule often struggle with determining what it means to "prevail" when the litigated result lies somewhere between the contending positions of the parties. The closer the litigated result is to the litigation position of the prevailing party the stronger the case for fee-shifting.

13. Whether the prevailing party is a natural person, a minor private party, a major party, the bankruptcy estate, or a governmental entity. In general the odds are stacked against natural persons and minor private parties in bankruptcy litigation. When they prevail the moral case for making them whole by an award of attorney's fees is stronger than for major parties, bankruptcy estates, and governments that have lots of fee-shifting and loss spreading capacity, win or lose.

14. Whether the non-prevailing party is a natural person, a minor private party, a major party, the bankruptcy estate, or a governmental entity. For the same reasons noted immediately above, an award of attorney's fees stings less, and is less likely to deny anyone access to the court, when it is made against a major party, the bankruptcy estate, or government.

15. An assessment of whom among the various constituencies in the bankruptcy will practically bear the economic incidence of fees initially borne by the estate.

B. A LOOK AT FEE-SHIFTING IN BANKRUPTCY IN ENGLAND.

The United States primary global competitor for large insolvency reorganizations is the United Kingdom²⁶⁸ and so it behooves us to look at how the question of attorney fee shifting is handled in the sophisticated financial reorganization practice taking place in London under the United Kingdom's Insolvency Act. The United Kingdom, of course, generally applies the English Rule on prevailing party attorney's fees. But against this background, the practice of awarding attorney's fees as costs has developed in interesting and

²⁶⁷See *supra* notes 212–239 and accompanying text (discussing *Penrod*).

²⁶⁸Anthony Casey & Joshua Macey, *Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars*, 37 EMORY BANKR. DEV. J. 463, 468 (2021).

nuanced ways in the United Kingdom. The current practice in UK cases involving “schemes of arrangement” is summarized in a leading treatise:

Important issues arise in relation to costs where a creditor does choose to mount a challenge. In *Re Stronghold Insurance Company Limited* Hildyard J stated that he would wish to make clear:

... my understanding (and certainly my usual practice) that, unless the objections are wholly improper or irrelevant, obviously collaterally motivated, or sprung on the scheme company without offering a proper opportunity for their discussion, there is very little likelihood of any adverse order for costs . . . ; and indeed there will usually be a real prospect of the relevant creditor recovering its reasonable costs of helpful and focused representation, fairly outlined in good time before the convening hearing to enable their proper consideration, on the class issues raised. [[2019] EWHC 2909 (Ch) at [145]]

This approach was endorsed by Snowden J as applicable in the context of a sanction hearing in *Ophir Energy Pl*, In the matter of *Ophir Energy Plc* [[2019] EWHC 1278 (Ch) at [39]] and by Norris J in *Inmarsat [plc]* [2020] EWHC 776 (Ch)]. However, in *Inmarsat* Norris J underlined that this should not be seen as an encouragement to objection. The position remained as stated by Warren J in *Re Peninsular Orient*:

I decline to elevate to some great principle of public policy the idea that, save in exceptional cases, objectors must, in order to ensure proper scrutiny of the scheme, always be immune from the normal costs rules provided that their objections are genuine and not frivolous. It seems to me that, as in any other litigation, the courts are perfectly capable of deciding on a case by case basis, what the justice of the case demands in relation to costs. [*Re Peninsular and Orient* [2006] EWHC 3279 (Ch) at [47]].

A further question arises as to whether the company can be required to pay the objecting creditors' costs. In *Inmarsat* Norris J declined to make any order as to costs. What mattered was not the identity of the objector but the nature and

substance of the objection: in *Inmarsat* ‘very thin gruel’. Thus, this was not a case in which the company ought to meet the objectors' costs. But, at the same time, it was also not a case in which an adverse costs order ought to be made, as the company could have responded earlier to concerns by market announcements.

Overall, the lesson of the cases for the company appears to be to concentrate on consultation and disclosure in advance of commencing the scheme process. The more the court can be persuaded that creditors were consulted and received adequate information, the less likely it is that the court will order the company to pay an objecting creditors' costs and there may even be a prospect of an adverse costs order against the objecting creditor. Merely pleading urgency without evidence is unlikely to persuade the court: the English courts are increasingly showing a skepticism of claims for urgency which are not made out in the evidence. And, as we shall see below, there is a growing focus on whether consultation was ‘even’ or whether some creditors were privileged over others in consultation and disclosure.²⁶⁹

We see in the most recent UK insolvency cases under Part 26A of the Companies Act of 2006 the continuing push-pull among (i) the desire to socialize the costs of the reorganization effort that benefit third parties (ii) the concern about unduly discouraging participation by all affected constituents in that effort and (iii) the problems posed by hold-outs, bullies and excessive litigiousness. In this respect the recent opinion of Mr. Justice Snowden in the *Matter of Virgin Active Holdings Ltd*²⁷⁰ is most instructive. Snowden had previously suggested that “creditors who attend a convening hearing” — the first hearing in a scheme or Part 26A restructuring plan at which the court confirms the company's choice of classes — “can expect to receive their reasonable costs irrespective of the outcome.” But in *Virgin Active* he characterizes these remarks as dicta that “overstated the approach of the court.” He then goes on:

²⁶⁹RODRIGO OLIVARES-CAMINAL, JOHN DOUGLAS, RANDALL GUINN, ALAN KORNBERG, SARAH PATERSON & DALVINDER SINGH, *DEBT RESTRUCTURING* §§ 3.03-3.04 (forthcoming 3d ed. 2021). Schemes of arrangement are the UK analog to our chapter 11. UK insolvency law also now provides for an informal composition procedure (a “company voluntary arrangement” or “CVA”). Some recent UK authority suggests court proceedings in relation to a CVA are generally governed by the English Rule rather than the more nuanced approach discussed in the text applicable to schemes of arrangement. *Id.* at §§ 3.01-3.02.

²⁷⁰2021 EWHC 911 (Ch) (Apr. 16, 2021).

Instead, on the basis of the authorities to which I have referred, it seems to me that the following principles can be stated in relation to scheme cases under Part 26,

- i) In all cases the issue of costs is in the discretion of the court.
- ii) The general rule in relation to costs under CPR 44.2 will ordinarily have no application to an application under Part 8 seeking an order convening scheme meetings or sanctioning a scheme, because the company seeks the approval of the court, not a remedy or relief against another party.
- iii) That is not necessarily the case (and hence the general rule under the CPR may apply) in respect of individual applications made within scheme proceedings.
- iv) In determining the appropriate order to make in relation to costs in scheme proceedings, relevant considerations may include,
 - a) that members or creditors should not be deterred from raising genuine issues relating to a scheme in a timely and appropriate manner by concerns over exposure to adverse costs orders;
 - b) that ordering the company to pay the reasonable costs of members or creditors who appear may enable matters of proper concern to be fully ventilated before the court, thereby assisting the court in its scrutiny of the proposals; and
 - c) that the court should not encourage members or creditors to object in the belief that the costs of objecting will be defrayed by someone else.
- v) The court does not generally make adverse costs orders against objecting members or creditors when their objections (though unsuccessful) are not frivolous and have been of assistance to the court in its scrutiny of the scheme. But the court may make such an adverse costs order if the circumstances justify that order.
- vi) There is no principle or presumption that the court will order the scheme company to pay the costs of an opposing member or creditor whose objections to a scheme have been unsuccessful. It may do so if the objections have not been frivolous and have assisted the court; or it may

make no order as to costs. The decision in each case will depend on all the circumstances.²⁷¹

* * *

As corporation reorganization practice in the United States and the United Kingdom continue to converge in the face of evolving realities in global finance²⁷² we thus see an interesting tendency of the UK authorities to allow for discretionary fee-shifting in a manner closely parallel to that suggested here. Notwithstanding the historic divergence between the US and UK in allocating the burden of attorney's fees generally, in insolvency cases both systems have, quite sensibly, groped toward a modified English Rule allowing for discretionary fee shifting sensitive to the realities of insolvency practice. It is time to join Justice Snowden in frankly acknowledging that neither the American Rule nor the English Rule in their pure forms has any application in this realm, and that the focus should be on properly guiding the court's exercise of its discretion to advance the goals of the reorganization process while ensuring both a fair allocation of costs and encouraging full but not abusive participation in the process by all affected constituents.

VII. CONCLUSION

Abandoning the American Rule and authorizing a discretionary version of the English Rule as the default rule in bankruptcy for recovery of attorney's fees is no radical step. Empirical work is limited, but in general supports the conclusion that shifts between the American Rule and various versions of the English Rule will have only a modest impact. In bankruptcy cases, there is already now, and always has been, an enormous amount of explicit and implicit fee shifting occurring.^{*} The bankruptcy courts have a well-developed set of procedures for regulating and allowing reasonable attorney's fees. Their control over fee allowances is an important constraint on those employing bullying and hold-out tactics calculated to confer leverage in bankruptcy negotiations by pressing weak claims and imposing costs on adversaries. And the bankruptcy courts in adjudicating the matters before them are well-positioned to exercise a sound discretion in the award of attorney's fees calculated to control such behavior when the claims and objections being pressed are meritless. We can identify a series of factors that will cabin the exercise of the court's discretion in an appropriate way designed to advance sound administration of bankruptcy cases and equitable considerations that have long been recognized. All the examples of fee-shifting regimes that we observe

²⁷¹*Id.* at ¶ 29.

²⁷²SARAH PATERSON, CORPORATE REORGANIZATION LAW & FORCES OF CHANGE (2021).

suggest courts will exercise discretion under a modified English Rule cautiously. The damage being done by the American Rule, though real, may be at the margins only. Moving to a discretionary rule authorizing recovery of attorney's fees by a prevailing party in the bankruptcy court may be a modest improvement in the bankruptcy process, but it is low-hanging fruit we should promptly gather in.
