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Allowance of Attorney Fees to an Unsecured Creditor (Part II)

By Ralph Brubaker

Whether an unsecured creditor's postpetition attorney fees can be allowed as a general unsecured claim against a debtor's bankruptcy estate remains an uncertain and unresolved issue, even after the recent Supreme Court decision of *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*¹ The *Travelers* opinion spoke to only one exceedingly narrow issue: holding that the Ninth Circuit's so-called *Fobian* rule—that “where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorney's fees will not be awarded”²—can have no application in claims allowance proceedings. That,

however, is not the most difficult nor divisive issue regarding allowance of attorney fees to an unsecured creditor. The most substantial differences of opinion have been regarding whether an unsecured creditor can claim, as an element of its general unsecured claim against a debtor's bankruptcy estate, contractual attorney fees incurred postpetition.³

The Ninth Circuit's decision in *Travelers*⁴ did not explore this issue and, unfortunately, neither did the briefing on the petition for a writ of certiorari. As a result, the Supreme Court's grant of certiorari was improvident. Rather than simply dismissing the petition on this basis after full merits briefing, the Court instead issued an opinion that is, by its

own acknowledgment, incomplete—leaving the basic issue entirely unresolved (both in general and as applied to the *Travelers* case itself). The Supreme Court's remand to the Ninth Circuit, however, provides a context for dissecting this particularly difficult and interesting issue of statutory interpretation.

Travelers' Indemnification Claim

The *Travelers* case arose out of the Chapter 11 proceedings of Pacific Gas & Electric (PG&E), with respect to PG&E's prepetition workers' compensation obligations. California law required PG&E to provide workers' compensation benefits for its employees by either

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Net Present Valuation: Summary and Application

By Robert J. Haupt

Net present valuation, recognizing the time and the value of money, describes a concept where a specific sum deemed earned over a period of years is discounted to a lesser amount when it is paid in advance of or at the beginning of the period for which the payment is being made. As you will see below, when the rate of inflation exceeds interest rates for a particular term, there is no net present value (NPV) effect.

NPV describes the amount that is to be paid over a period of years and the

two factors that affect it—the interest rate at which the money can be invested and the anticipated rate of inflation. The rate is then adjusted to a lesser amount that can be paid now, so the recipient ends up in the same position now that he or she would be in if he or she were paying the greater amount over time. For example, \$1000 per month for 20 years is \$240,000. However, \$240,000 today, if invested, would earn interest and could thus pay out that \$1000 per month for 20 years and still have money left over at

the end of the 20 years. Similarly, some amount less than \$240,000 could be invested and could use the earned interest to pay that same \$1000 per month for 20 years. Specifically:

Example 1

\$240,000 invested at a 4 percent annual interest rate could pay \$1000 per month and have \$166,645 left over at the end of 20 years. Here, the \$1000 per month

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is greater than the projected interest earned.

Example 2

\$240,000 invested at a 5 percent annual interest rate could pay \$1000 per month and have the full \$240,000 left over at the end of 20 years. Here, the \$1000 per month is equal to the projected interest earned.

Example 3

At the same time, if one wanted to invest an amount sufficient to pay the \$1000 per month for 20 years, based on a 4 percent return on the investment, it would require only \$165,022. Here, there is nothing left at the end of the 20 years.

The effect of an NPV is more pronounced during times when there is a substantial difference between the rate of return one can earn on invested money versus the rate of inflation.

The greater the amount of interest that one can earn on a sum of money over the next period of years, the less money it will take to pay out a monthly amount—not so complicated thus far.

The process gets more complicated when you have to go the other direction.

What does that mean? As any consumer will recognize, \$1.00 will buy less today than it likely will in the future. As a middle-aged man, I can remember when a gallon of gas cost less than \$1.00, when health insurance was available for under \$80 per month, and when a big candy bar cost 10 cents. The same thing holds true when projecting how much money it will take to get an individual \$1000 per month of benefit over the next period of years. This is the cost of living (COL). The change in this cost is called economic inflation. Each year, the U.S. Department of Labor publishes a Consumer Price Index (CPI) measuring the average purchasing power of money today versus a base measure calculated as the average for the years 1982–1984. It compares prices by purchased item from year to year, from one region of the country to another. It can be found on the U.S. Department of Labor's Bureau of Labor Statistic's website.¹ Using a similar analysis as above, if one projected a 4 percent COL annual increase over 20 years, \$1000 today will buy only \$442 worth of goods 20 years from now.

When properly calculating NPV, one must calculate the value incorporating both a reasonable anticipated investment opportunity of the money and the diminished value of the available money based upon a projected COL. Of course, economists argue over what those projected factors should be. These two factors work to offset each other. The effect of an NPV is more pronounced during times when there is a substantial difference between the rate of return one can earn on invested money versus the rate of inflation. Right now, no example of inflation is better than that of fuel. Below is the same general example from above, now including the effect of inflation:

Example 4

\$239,203 invested at 4 percent annual interest rate subject to a 4 percent rate of inflation, could pay \$1000 per month, leaving nothing left over at the end of 20 years. With the inflation rate added, the amount of initial investment required compared to that of example 3 increases by nearly 50 percent.

While the 4 percent rate of interest and the 4 percent inflation rate do not entirely offset each other arithmetically, the effect is virtually just that. When the rate of interest is greater than the inflation rate, it takes less money to pay out the same monthly amount. When the rate of inflation is greater than the rate of interest that can be earned, even more initial money is required to make the same "effective" payment to the individual.

From September 2007 to September 2008, the national CPI of all goods increased by 4.9 percent. From September 2006 to September 2007, the increase was only 2.8 percent. If you feel that things are getting tighter, it is because they are. As I am writing this, a brief Internet check demonstrated that there are five-year certificates of deposit available at banks around the country paying from 3.50 percent to 5.15 percent. One-year CDs are currently paying only from 1.98 percent to 2.86 percent. Obviously, the lenders are anticipating that interest rates are going to climb. Applying this to our analysis, on average, it appears that the rate of inflation is currently exceeding the amount being paid on mid-term CDs—so it will take more money today, regularly invested, to secure a consistent effective monthly distribution over the foreseeable future. Using approximations of today's numbers:

Example 5

It would require \$306,846 today invested at a 2.5 percent annual interest rate subject to a 4.9 percent rate of inflation, to earn what is equivalent to \$1000 per month today, leaving nothing left over at the end of 20 years.

One application of this notion to bankruptcy matters can be found in 11 U.S.C. § 502(b), where it has been asserted that all claims for future payments must be reduced to present value as of the date of the filing of the petition.² The court there adopted that seemingly apparent and common-sensible idea that a dollar invested today produces more than a dollar in value in the future. Or alternatively, a future dollar can be bought with less than a dollar, today. However, that holding overstates the requirement found in Section 502(b)—the court “shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition . . .” The conclusion reached in *Pension Benefit Guaranty Corp.* presupposes that there is always an NPV discount.

Net present valuation has been recognized for centuries as a viable mechanism for aiding in decision making.

As is apparent today, there is no NPV discount needed because any NPV would actually be greater than the sum of the future payment when including the diminished value of that same dollar in the future. A fair settlement or claim valuation today would require more dollars paid than the sum of the total payments themselves. Using real dollars, it will take more than \$1000 today to buy

\$1000 in the future (even when figuring in the investment opportunity of that initial \$1000).

Net present valuation has been recognized for centuries as a viable mechanism for aiding in decision making. Beginning in the early 1930s, this concept was increasingly used as a mechanism for valuing businesses; replacing the dominating, pre-Depression era of cost-based valuation of stocks; and financial instruments. Today, its application and use is integral to virtually all financial analysis and evaluation. Over the last 20 years, this same analysis has been applied increasingly to evaluations of social and personal decision making. One of my former professors, University of Chicago economist and Nobel Prize winner Gary Becker was recognized for his leadership in applying economic constructs to behavioral patterns. Others have increasingly applied it to legal theorization. Here, our analysis is simple: We are limiting the use of the concept to dollars and cents. When a court needs to determine a time of petition valuation or when a party is confronted with considering either making a settlement offer, accepting one, or in either instance, negotiating a resolution, its legal counsel must be able to analyze and explain what it will take in today's dollars to provide the needed resources for what is often a long-term need.

This analysis can be misapplied in instances where the harm suffered is already mature. By this, I mean that the harm is not one measured by chronological harm, such as in the case of a lost source of income. When one is injured to the extent he or she can never again work, part of the measure of harm is the lost monthly income to that individual. Properly invested, the cost of remedying that harm can be calculated in net present dollars, as illustrated above. However, when the loss is a non-revenue one—such as pain or trauma—and the harm that is experienced may be fully realized in the present term, it makes no sense to attempt to net present value or discount the amount of the value of that harm. In tort cases where there is harm, but when loss of income is not part of the evalua-

tion, there is no net present discounting. In one recent state court matter involving harm to a child with some liability recognized by a governmental entity, a state attorney attempted to apply this discount to a Governmental Tort Claims Act claim. This is inappropriate. The harm is not one remedied by a monthly income stream. The remedy there is for the present injury to the individual. Examples of other applications of net present valuation to bankruptcy include:

- valuation of estimated personal injury claims against a debtor for purpose of plan viability determination³
- valuation of debtor's future liability on promissory notes⁴
- valuation of claims based on debtor's ability and obligation to make cash payments subsequent to filing date⁵
- determination of amount of unmat-ured claim as of petition date⁶
- determination of adequate protec-tion⁷
- determination whether claims for a Chapter 11 debtor's minimum contributions to an employee pension plan are entitled to tax or administrative priority⁸

While it is clearly useful to have the assistance of an expert witness in explaining this analytical process to a court or jury, it does not appear to require an expert to testify as to this analysis before a fact-finder. The standard for requiring expert testimony is clear. When the fact in issue is such that its consideration is outside that of normal and ordinary life experiences, expert testimony is required.⁹ Here, the concept is simple enough that it can be presented even to a jury in terms that are understandable to a nonexpert. More than that, even a fact witness can testify as to his or her own personal and professional income expectations. Once allowed, the testimony of either the fact or expert witness is for the trier of fact to consider and weigh. All of us know that a dollar today is likely worth less than a dollar tomorrow (i.e., inflation). All of us have

some expectation of what a reasonable rate of increase might be for one in a particular job or by purchase or deposit in some secure instrument (i.e., investment). Precise? Absolutely not. Possible? Certainly.

According to numbers recently released by both the U.S. Department of Labor and the Federal Reserve, there are indications that inflation is headed back to the double-digit numbers of the early 1980s. Should this trend continue, the entire notion of NPV discounting can be placed in a credenza drawer, waiting for times to eventually rebalance themselves. The analysis can be made most simple by remembering this: When the rate of interest rates is greater than the rate of inflation, it takes less money on the front end to make the necessary payments to the victim—an NPV discount can be taken. When, as today, the rate

of inflation exceeds the rate at which funds routinely can be invested, not only is it inappropriate to take a discount, but the award should also be increased to accommodate projected inflation. And of course, when investment rates (i.e., interest) are approximately that of inflation, then simple math applies: Multiply the number of months by the anticipated loss of wages or other loss as the case may be.

Robert J. Haupt is a bankruptcy and commercial litigator with the firm Phillips Murrah, PC in Oklahoma City, Oklahoma.

Endnotes

1. bls.gov/CPI/.
2. Pension Benefit Guar. Corp. v. CF&I Fabricators of Utah, Inc. (*In re* CF&I Fabricators of Utah, Inc.), 150 F.3d 1293 (10th Cir. 1998); *In re* CSC Indus., Inc. 232 F.3d 505, 508 (6th Cir. 2000).
3. *In re* Aquaslide Va'N' Dive Corp., 85 B.R. 545 (B.A.P. 9th Cir. 1987).
4. *In re* Lowen Group Int'l, Inc., 274 B.R. 427 (Bankr. D. Del. 2002).
5. *In re* Chateaugay Corp., 126 B.R. 165 (Bankr. S.D.N.Y. 1991).
6. *In re* Trace Int'l Holdings, Inc., 284 B.R. 32 (Bankr. S.D.N.Y. 2002); *In re* U.S. Airways Group, Inc., 303 B.R. 784 (Bankr. E.D. Va. 2003); *In re* Rhodes, Inc., 382 B.R. 550 (Bankr. N.D. Ga. 2008).
7. *In re* Collins, 167 B.R. 842 (Bankr. E.D. Tex. 1994).
8. Pension Benefit Guar. Corp. v. CF&I Fabricators of Utah, Inc., 150 F.3d 1293, 1295 (10th Cir. 1998).
9. *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579, 592-93, 113 S. Ct. 2786, 2796 (1993), *United States v. Finley*, 301 F.3d 1000, 1007 (9th Cir. 2002).

Message from the Cochairs

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energy and enthusiasm were the catalyst for many of our activities. Kathleen will remain active as a member of the committee and is now serving the American Bar Association as a cochair of the Federal Practice Task Force. We wish her the best in her new role and again extend our appreciation to Kathleen for her years of service to the committee.

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