Enforcing Contractual Attorney's Fees as an Element of Nondischargeable Debt: Transouth Financial Corp. of Florida v. Johnson

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ENFORCING CONTRACTUAL ATTORNEY'S FEES AS AN ELEMENT OF NONDISCHARGEABLE DEBT: TRANSOUTH FINANCIAL CORP. OF FLORIDA v. JOHNSON

The prevailing policy of the Bankruptcy Code (the "Code") is to provide bankrupt debtors with a "fresh start." Consequently,


Protecting the honest debtor has long been a paramount concern in American bankruptcy law. See Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (stating that bankruptcy "gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt"); 1A JAMES W. MOORE, COLLIER ON BANKRUPTCY ¶ 14.01(6) (14th ed. 1978) ("for the honest debtor, be he a low salaried wage earner or entrepreneur, a discharge provides him with the incentive to use his skills and talents, and thereby contribute to society even after financial disaster"); see also H.R. Rep. No. 65, 55th Cong., 2nd Sess. 32 (1897) ("The friends of a bankruptcy law contend that when an honest man is hopelessly down financially, nothing is gained for the public by keeping him down, but, on the contrary, the public good will be promoted . . . by letting him start anew.") (citing H.R. Rep. No. 1228, 54th Cong., 1st Sess. 5 (1897)). But see DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS AND MATERIALS ON BANKRUPTCY 31 (1985) (value of bankruptcy laws measured by degree to which they enhance creditors' collection efforts); Thomas H. Jackson, The Fresh Start Policy in Bankruptcy Law, 98 HARV. L. REV. 1393, 1426-31 (1986) (explaining why discharge must be made costly to debtor).

The term "fresh start" was first used by the Supreme Court in 1904 in Wetmore v. Markoe, 196 U.S. 68, 77 (1904). The Wetmore court held that "[s]ystems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a fresh start . . . freed from the obligation and responsibilities which may have resulted from . . . misfortunes." Id.; see also Neal v. Clark, 95 U.S. 704, 709 (1877) (describing bankruptcy as "a general law by which the honest citizen may be relieved from the burden of hopeless insolvency."). Various forms of debtor relief have existed since ancient times. See generally Vern Countryman, A History of American Bankruptcy Law, 81 COM. L.J. 226, 231 (1976) (survey of bankruptcy legislation since 1800); Charles G. Hallinan, The "Fresh Start" Policy in Consumer Bankruptcy: Historical Inventory and an Interpretative Theory, 21 U. RICH. L. REV. 49, 53-55 (1986) (historical outline of American "fresh start" doctrine); Margaret Howard, A Theory of Discharge in Consumer Bankruptcy, 48 OHIO ST. L.J. 1047, 1047 n.4 (1987) (review of American bankruptcy statutes); Elizabeth Warren, Bankruptcy Policy, 54 U. CHI. L. REV. 775 (1987) (defining and deriving bankruptcy
the Code provides debtors with a discharge of indebtedness. An exception to this general rule is recognized in section 523(a)(2) of the Code, under which creditors may initiate adversary proceedings against fraudulent debtors who seek to render their debts nondischargeable. In order to discourage meritless nondischargeability claims, Congress enacted section 523(d), which

policy).


See 11 U.S.C. § 727. This section grants discharge to the individual debtor. Id. A discharge pursuant to section 727 is granted when a debtor files for relief under Chapter 7 of the Code. Id. Discharge refers to "[t]he release of a debtor from all of his debts which are provable in bankruptcy." BLACK'S LAW DICTIONARY 463 (6th ed. 1990); see also infra note 5 (list of other discharge provisions in Code) & note 11 (outline of filing procedure under Chapter 7).

† 11 U.S.C. § 523. That section states, in pertinent part:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any "debt"—

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing —

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services or credit reasonably relied; and

(iv) that the debtor caused to be made or published with the intent to deceive. . .

Id. The right of discharge has never been absolute. See generally 8 WILLIAM S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 234-36 (2d ed. 1937) (general exceptions to discharge in English bankruptcy law); 1 HAROLD REMINGTON, A TREATISE ON THE BANKRUPTCY LAWS OF THE UNITED STATES §§ 8-9 (5th ed. 1950) (statutory exceptions to discharge in United States); Charles J. Tabb, The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate, 59 Geo. Wash. L. Rev. 56, 58-59 (1991) (outlining history of American law regarding exceptions to discharge).


(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

Id. The legislative history of section 523(d) added:

Creditor practices [of manipulating debtors into filing false financial statements] . . .
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mandates an award of attorney's fees to prevailing consumer debtors whose debts remain dischargeable even after section 523(a)(2) adversary proceedings.\(^8\)

However, since no such award is available to prevailing creditors,\(^7\) an issue arises when a prevailing creditor has a contractual right to collect attorney's fees from the debtor.\(^8\) Recently, in have been so strong that the Bankruptcy Commission recommended that the false financial statement exception to discharge be eliminated for consumer debts. This bill recognizes, however, that there are actual instances of consumer fraud, and that creditors should be protected from fraudulent debtors. It retains the exception . . . [b]ut it also recognizes that the leverage creditors have over their debtors . . . when bankruptcy ensues.

The threat of litigation over the [false financial statement] exception to discharge and its attendant costs are often enough to induce the debtor to settle for a reduced sum, in order to avoid the costs of litigation. Thus, creditors with marginal cases are usually able to have at least part of their claim excepted from discharge . . . even though the merits of the case are weak . . .

In order to balance the scales more fairly in this area, . . . [t]he false financial statement exception is retained, and the creditor . . . is required to initiate the proceeding to determine if the debt is nondischargeable. If the debtor prevails, however, the creditor is taxed costs and attorney's fees . . . . The present pressure on the honest debtor to settle in order to avoid attorney's fees . . . is eliminated. The creditor is protected from dishonest debtors by the continuance of the exception to discharge.


The contingency that the creditor will be assessed fees only if his position is "not substantially justified" mirrors the language of the Equal Access to Justice Act (EAJA). See 28 U.S.C. § 2412(d)(1)(A) (1990). The EAJA standard of determining fees is appropriate in analyzing 11 U.S.C. § 523(d). See Citizen's Nat'l Bank v. Burns (In re Burns), 894 F.2d 361, 362-63 n.2 (10th Cir. 1990) (discussing congressional intent to employ identical standard); America First Credit Union v. Shaw (In re Shaw), 114 B.R. 291, 294-95 n.6 (Bankr. D. Utah 1990) (court, for guidance, looked to cases interpreting similar language of EAJA). Congress sought to "strike the appropriate balance between protecting the debtor from unreasonable challenges to dischargeability of debts and not deterring creditors from making challenges when it is reasonable to do so." Burns, 894 F.2d at 362 n.2 (citing S. Rep. No. 65, 98th Cong., 1st Sess. 9-10 (1983)).

* See Legislative History, supra note 5, at 6092-93. Congress reasoned that "[i]f the provision were . . . permissive instead of mandatory, with discretion in the court to award such amounts as were proper in each particular case, the debtor would once again be subject to the risk of paying attorney's fees . . . . Making the provision discretionary would seriously weaken the protection it provides [to the consumer debtor]." Id.

7 See Legislative History, supra note 5, at 6092. "The bill does not award the creditor attorney's fees if the creditor prevails. Though such a balance might seem fair at first blush, such a provision would restore the balance back in favor of the creditor by inducing debtors to settle . . . ." Id.; see also Bud Antle, Inc. v. Elliott (In re Elliott), 93 B.R. 776, 779 (Bankr. M.D. Fla. 1988) (prevailing creditor in dischargeability action not entitled to attorney's fees absent authorization in Code).

8 Compare Grove v. Fulwiler (In re Fulwiler), 624 F.2d 908, 910 (9th Cir. 1980) (judgment adverse to debtor's request for attorney's fees under Act due to lack of bad faith by
TranSouth Financial Corp. of Florida v. Johnson, a divided Eleventh Circuit held that a creditor, successful in a section 523(a)(2) nondischargeability proceeding, is entitled to recover such attorney’s fees as provided for by contract.

In TranSouth, Mr. and Mrs. Johnson (the “Debtors”) filed a Chapter 7 petition in bankruptcy. TranSouth Financial Corp. of Florida (“TranSouth Financial”) initiated an adversary proceeding against the Debtors in the United States Bankruptcy Court for the Middle District of Florida in order to except its debt from


931 F.2d 1505 (11th Cir. 1991).

10 See id. at 1509. The case highlighted the conflicting policies of protecting creditors’ expectations and limiting debtors’ liabilities. Id. at 1508-09. It also confronted the clash between federal bankruptcy law and the enforcement of state law contractual rights. Id. at 1507, 1515-16. In a two to one decision, the court followed state law and balanced the conflicting policies in favor of the creditor. Id. at 1509.

11 TranSouth, 931 F.2d at 1506. In December, 1985, TranSouth established a revolving line of credit for the Johnsons in exchange for a promissory note. Id. at 1505. On September 23, 1986, the Johnsons filed a petition for an order for relief under Chapter 7 of the Bankruptcy Code. Appellant’s Brief at 7. TranSouth (No. 89-4036).

Chapter 7 of the Bankruptcy Code governs liquidation. See 11 U.S.C. §§ 701-66 (1990). Any debtor, except banks, insurance companies and railroads, may seek voluntary relief under Chapter 7. Id. § 301. When an order for relief is granted, the court then appoints a trustee, to whom the debtor surrenders all his assets. See id. § 701. Section 541 enumerates those assets exempt from surrender. See id. § 541. The trustee, based on a list of creditors set forth by the debtor, must first distribute the assets among those creditors who have priority according to section 507. Id. § 507. Subsequently, the remaining creditors on the list are generally entitled to receive a pro rata share of any assets which remain. Id. § 726. At this point, subject to exceptions or waivers, the petitioner’s debts are discharged. See id. §§ 523, 727 (exceptions to discharge); see also supra note 2 (explaining how § 727 gives debtor “fresh start”). See generally Irving A. Breitowitz, New Developments in Consumer Bankruptcies: Chapter 7 Dismissal on the Basis of “Substantial Abuse”, 59 AM. BANKR. L.J. 327, 330-32 (1985) (chapter 7 process).

12 See Appellant’s Brief, supra note 11, at 1. TranSouth Financial Corporation of Florida was originally incorporated in Florida. Id. It has since merged, and is now called TranSouth Financial Corporation. Id. TranSouth Financial Corporation is a South Carolina corporation based in Florence, South Carolina, which does business in the state of Florida. Telephone interview with Jim Armstrong, General Counsel for TranSouth working in Dallas, Texas (July 16, 1991).
discharge on the ground of debtor fraud. The original debt was expressed in a promissory note (the "Note"), which included a clause obligating the Debtors to pay TranSouth Financial's attorney's fees should TranSouth Financial incur legal costs in collecting on the debt. Prior to a determination by the bankruptcy court, the parties filed a settlement stipulation (the "Stipulation"), stating that the debt was not to be discharged, and that TranSouth Financial's attorney's fees incurred in the proceeding were to be considered part of the debt.

Writing for the bankruptcy court, Chief Judge Paskay allowed TranSouth Financial to collect its debt pursuant to the Stipulation and the Note, but held that despite the terms of each, there was no authority to support an award of attorney's fees. On appeal, the district court affirmed the bankruptcy court's order, and added that the reasoning of the bankruptcy court was consonant with the legislative history of section 523.

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13 TranSouth, 931 F.2d at 1505; see Telephone Interview with Catherine Peek McEwen, of Moffitt, Hart & Herron, attorneys for Appellant (July 16, 1991). The Johnsons' stated purpose in obtaining the loan was to purchase a big-screen television. Id. The basis for TranSouth Financial in bringing the proceeding pursuant to the debtor fraud exception to the discharge provision in section 523(a)(2) was the fact that the Johnson's stated purpose for the loan conflicted with its actual purpose. Id.; see also 11 U.S.C. § 523(a)(2) (loan obtained through fraud is nondischargeable in bankruptcy).

14 TranSouth Fin. Corp. of Fla. v. Johnson, 931 F.2d 1505, 1510 (11th Cir. 1991) (Clark, J., dissenting). The Note provided that the Johnsons would be liable for "our reasonable lawyer's fees of 15% of the unpaid balance or $150.00, whichever is greater." Id. at 1506. The Stipulation, in relevant part, provided as follows:

(1) TranSouth is a creditor of the Johnsons; (2) TranSouth has incurred costs in this adversary proceeding; (3) judgment should be entered in favor of TranSouth for an amount equal to the principal of the debt, the costs incurred in its collection, interest, and reasonable attorney's fees as provided by the Note; and (4) the debt at issue qualifies as an exception to discharge pursuant to § 523(a)(2).

Id. Pursuant to the Stipulation, which was entered into in February, 1988, the principal amount owed was settled at $2,000.00, and costs were settled at $150.25. Id. at 1507. The interest rate as provided by law was to be 12% per annum, and the reasonable attorney's fees were agreed to total $300.00. Id. at 1510-11 (Clark, J., dissenting). Judge Clark noted that the total debt outlined in the Stipulation, including the attorney's fees, was less than the original principal owed on the Note. Id. at 1510.

15 See TranSouth Fin. Corp. of Fla. v. Johnson, No. 87-0078, slip op. at 2 (Bankr. M.D. Fla. March 3, 1988). Chief Judge Paskay held that "notwithstanding the parties' stipulation and the terms of the note, there is no authority for an award of attorney's fees to Plaintiff in a dischargeability proceeding such as this." Id.; see also Bud Antle, Inc. v. Elliott (In re Elliott), 93 B.R. 776, 779 (Bankr. M.D. Fla. 1988) (court rejected parties' agreement to include attorney's fees).

16 TranSouth Fin. Corp. of Fla. v. Johnson, No. 88-413-Civ-T-15A, slip op. at 4 (M.D. Fla. Oct. 31, 1989). In affirming the decision of the Bankruptcy Court, Judge Castagna
The Eleventh Circuit granted TranSouth Financial's leave to appeal. Writing for the majority, Judge Birch reconciled the plain language of the Code with a creditor's contractual right to receive attorney's fees from a fraudulent debtor. Initially, the court recognized that in federal court, a creditor's right to attorney's fees under a contract constituted an exception to the generally accepted American Rule that each party must bear the costs.

wrote "[t]he legislative history documents the reluctance of Congress to authorize attorney's fees awards to creditors . . . . Inasmuch as dischargeability and the exceptions to discharge are federal causes of action . . . legislative intent regarding claims filed pursuant to this statute require[s] substantial deference." Id.; see Legislative History, supra note 5 (record of legislative history).

18 TranSouth, 931 F.2d at 1509. Since the debt had already been discharged, the majority felt that its task lay in defining the elements of the debt. Id. at 1507.

The TranSouth majority began its analysis of "debt" under section 523 by looking to the plain language of the Code. Id. at 1508; see also Board of Educ. v. Mergens, 110 S. Ct. 2856, 2865 (1990) (general principle of employing plain language of statute); United States v. Turkette, 452 U.S. 576, 580 (1981) (same); DALLAS C. SANDS, SUTHERLAND ON STATUTORY CONSTRUCTION § 46.01 (14th ed. 1975) (addressing importance of statutory language in interpretation); Quintin Johnstone, An Evaluation of the Rules of Statutory Interpretation, 3 KAN. L. REV. 1, 12-13 (1954) (plain meaning preserves legislative supremacy).


The Supreme Court first promulgated the American Rule in 1796 in Arcambel v. Wise-


The American Rule has been criticized by commentators. See Albert Ehrenzweig, Reim-

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of its own litigation. In granting attorney's fees to TranSouth Financial, the court noted that the absence of a federal statutory award did not preclude a prevailing creditor's right to contractual attorney's fees—it merely did not provide a "separate statutory basis" for such an award.

In dissent, Judge Clark argued that a contract enforceable under state law should not undermine the federal nature of the remedy requested in the principal case. In addition, he posited...


See United States v. Carter, 217 U.S. 286, 322 (1910) (valid state law contractual rights to attorney's fees enforceable in federal question litigation). Federal courts have consistently recognized statutory and contractual authorization as exceptions to the American Rule. See, e.g., Summit Valley Indus., Inc. v. Carpenters, 456 U.S. 717, 721 (1982) (attorney's fees not recoverable in federal court except where pursuant to statute or enforceable contract): Hall v. Cole 412 U.S. 1, 4-5 (1973) (same); Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 717 (1967) (same). Certain federal statutes codify exceptions to both the American and English rules through fee shifting provisions. See also Larson, infra note 32, at 323-27 (citing over one hundred twenty federal fee shifting statutes).

See TranSouth, 931 F.2d at 1507-08. TranSouth relied on Security Mortgage Co. v. Powers, 278 U.S. 149, 153-54 (1928) and Martin v. Bank of Germantown (In re Martin), 761 F.2d 1163, 1168 (6th Cir. 1985) to uphold the state law obligation requiring the debtor to pay attorney's fees. Id. In Martin, Judge Martin recognized that Congress did not intend to provide creditors with a statutory right to fees. Therefore, the holding was limited to cases in which prevailing creditors in section 523(a)(2) proceedings enjoyed an independent right to such fees by virtue of contract. Martin, 761 F.2d at 1168; see also In re Saab, No. 91-1892, 1991 U.S. Dist. LEXIS 15612, at *11 (E.D. La. Oct. 30, 1991) (permissible for creditor to recover attorney's fees where contractual right exists under state law).

TranSouth, 931 F.2d at 1515 (Clark, J., dissenting) (state court judgment of nondischargeability was not res judicata in subsequent federal bankruptcy dischargeability proceeding) (citing Brown v. Felsen, 442 U.S. 127, 131 (1979)).

Judge Clark's primary concern in his dissent was that TranSouth Financial did not have a justiciable controversy. Id. at 1510. Since the settled amount was less than the debt, Judge Clark felt that "[t]he posture of the parties throughout these proceedings suggests that the appellant crafted the terms of the settlement solely for the purpose of getting the attorney's fee issue before the court in a non-adversarial context." Id. at 1511. Judge Clark also noted an exchange between himself and counsel for TranSouth Financial, during which TranSouth agreed that the Stipulation brought up an "issue without an opponent." Id. Judge Clark added that "no justiciable controversy is presented in the absence of a defendant having an interest adverse to that of the plaintiff." Id. (citing Moore v. Charlotte-
that the legislative history of section 523(d) precluded any award of attorney's fees to a prevailing creditor.\textsuperscript{24} According to the dissent, "even if attorney's fees constitute 'debt' under state law, Congress, through federal bankruptcy law, has evidenced an intent to disallow attorney's fees as an element of debt owed to a prevailing creditor in a section 523 nondischargeability proceeding."\textsuperscript{25}

This Comment will suggest that by enforcing a contractual attorney's fees provision in favor of a prevailing creditor in a bankruptcy nondischargeability proceeding pursuant to section 523(a)(2) of the Code, the Eleventh Circuit has, in this limited circumstance, appropriately expanded the definition of nondischargeable debt. Part One of this Comment will suggest that the federal Bankruptcy Code does not preempt enforcement of a contract provision awarding attorney's fees to creditors who prevail in a section 523(a)(2) adversary proceeding. Additionally, it will examine the enforceability of such a provision in the context of the purpose and language of section 523(d) of the Code. Part Two will examine prior decisions on this issue and the reasoning used by those courts to conclude that awarding such attorney's fees is not in contravention of the Code's underlying policies. Finally, this Comment will conclude that the TranSouth court appropriately measured the respective rights of the parties and reached an equitable result.

Mecklenberg Bd. of Educ., 402 U.S. 47, 48 (1971)). \textit{But see} Pope v. United States, 323 U.S. 1, 11 (1944) (suit to enforce legal obligation is not any less case or controversy because plaintiff's claim is uncontested or incontestable); Aetna Life Ins. Co. v. Haworth, 300 U.S. 227, 240-41 (1937) (dispute relating to legal rights and obligations touches legal relations of parties and is justiciable). \textit{See generally} Laurence H. Tribe, \textit{American Constitutional Law} § 3-12, at 94 (2d ed. 1988) (disagreement over general principle, without any other basis for conflict, is not justiciable).

\textsuperscript{24} TranSouth, 931 F.2d. at 1514 (Clark, J., dissenting). Judge Clark wrote, "As the legislative history indicates, Congress purposefully sought to prevent creditors from asserting undue leverage on debtors by threatening them with litigation costs and attorney's fees if the debtor refused to reaffirm her debt." \textit{Id.} at 1515.

\textsuperscript{25} \textit{Id.} at 1516 (Clark, J., dissenting).
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I. FEDERAL BANKRUPTCY LAW AND THE APPLICABILITY OF STATE-CREATED RIGHTS

A. Limits on Preemption

The United States Constitution empowers Congress to create uniform bankruptcy laws throughout the United States. Pursuant to the Supremacy Clause of the Constitution, federal legislation may preempt state law. One way preemption occurs is through express congressional intent. However, since the Code does not expressly preempt a state law award of contractual attorney's fees to a creditor who prevails in a section 523(a)(2) proceeding, it is necessary to examine whether Congress implicitly pre-

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26. U.S. Const. art. I, § 8, cl. 4. Congress was granted the power "to establish . . . uniform laws on the subject of Bankruptcies throughout the United States."
27. Id. at art. VI, cl. 2. The Supremacy Clause provides:
29. Although Congress has the power to preempt state law, we should begin any analysis "[w]ith the basic assumption that Congress did not intend to displace state law." Maryland v. Louisiana, 451 U.S. 725, 746 (1981).
empted state law by perversely "occupying the field." Since creditors' attorney's fees provisions are so widespread, it can be inferred from legislative silence that Congress did not intend to "occupy the field" and regulate said contractual agreements.

Additionally, to the extent state law conflicts with federal bankruptcy law, the former will be preempts. State law will be upheld, however, if compliance with both the federal and state laws is possible. In a section 523(a)(2) adversary proceeding, a creditor must prevail before any rights to attorney's fees arise under the contract, and the debtor must prevail in order to receive an award of attorney's fees pursuant to section 523(d). Since the creditor and debtor cannot both prevail in the same proceeding, it is suggested that the two rights are mutually exclusive and can peacefully coexist.

Furthermore, courts will enforce state law when such enforcement will not frustrate the purpose of the congressional Act at issue. The purpose of awarding attorney's fees to prevailing creditors (noting "congressional failure to award attorney's fees to prevailing creditors"); Legislative History, supra note 5, at 6092 (same).

See Wisconsin Pub. Intervenor v. Mortier 111 S. Ct. 2476, 2478 (1991). In discussing whether Congress intended to occupy a given field of legislation, the court stated, "Absent explicit preemptive language, congressional intent to supersede state law may nonetheless be implicit if, for example, the federal Act touches a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." Id.; see also Donald P. Rothschild, A Proposed "Tonic" with Florida Lime to Celebrate Our New Federalism: How to Deal With the "Headache" of Preemption, 38 U. MIAMI L. REV. 829, 844 (1984) (illustration of clear congressional intent to preempt).

See Jordan, 927 F.2d at 227 (no hint in section 523(d) of intention to prevent award of attorney's fees to creditors so entitled under contract); Martin, 761 F.2d at 1168 (same); Commercial Factors of Salt Lake City, Inc. v. Jensen (in re Jensen), 113 B.R. 51, 54 (Bankr. D. Utah 1990) (rejecting argument that congressional silence precludes fee award provided by contract); Legislative History, supra note 5, at 6092 (absence of any indication to prevent enforcement of contract).


See infra note 35 (state law upheld if compliance with state and federal law does not frustrate congressional purpose).

See Hines v. Davidowitz, 312 U.S. 52, 67 (1941). The court conceded that there was no fixed method of ascertaining congressional intent. See id. The court stated that the criti-
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debtors was to protect those debtors from frivolous nondischargeability claims. After *TranSouth*, however, it appears that the debtor remains protected because a nonprevailing creditor will still have to pay section 523(d) attorney's fees should that creditor bring a frivolous nondischargeability claim. If the creditor is successful, however, it would seem that there was merit to the claim for exception and the need to protect the debtor against frivolous claims disappears.

B. Defining the Nondischargeable Debt

In *Brown v. Felsen*, the Supreme Court held that the dischargeability of a debt shall be federally determined. However, the court failed to define the debt that is exempt from discharge. Under the Code, debt is liberally defined as a “liability on a claim.” Therefore, it can be argued that when an exception
to discharge reinstates a debtor's obligations under a contract, provisional attorney's fees are part of the debt as defined by the Code and the contract—attorney's fees should be included in calculating "the whole of any debt" to be excepted from discharge. Furthermore, it is submitted that a court must necessarily look to the obligations in the promissory note, which are governed by state law, to clarify the amount of the debt.

Another approach to defining debt includes viewing a section 523(a)(2) proceeding as an action in tort. It would then follow that the creditor's injuries must be proximately caused by the debtor's fraud in order for the creditor to recover. Generally, loss of the principal amount of the loan is the only foreseeable result of the fraud. In *TranSouth*, however, attorney's fees were

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* Martin v. Bank of Germantown (*In re Martin*), 761 F.2d 1163, 1168 (6th Cir. 1985); *see TranSouth*, 991 F.2d at 1507 ("[t]he 'debt' excused . . . would appear to include a debtor's contractual obligation to pay a creditor's attorney's fees"); *Jensen*, 113 B.R. at 54 (attorney's fees arising out of enforcement of valid contract are part of debt pursuant to Code section 101(12)).


* See KEETON ET AL., supra note 44, at 274 (test of foreseeability determines proximate cause). Unforeseeable consequences are generally not recoverable on the contract. See Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854). In Baxendale, Baron Alderson held that, "[w]here two parties have made a contract which one of them has broken, the damages which the other party ought to receive . . . should be such as . . . may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract . . . ." Id. at 351, 156 Eng. Rep. at 151. See generally Richard Danzig, Hadley v. Baxendale: A Study in the Industrialization of the Law, 4 J. LEGAL STUD. 249 (1975) (discussion of background and applicability of Hadley v. Baxendale); Edwin W. Patterson, The Apportionment of Business Risks Through Legal Devices, 24 COLUM. L. REV. 335, 342 (1924) (Baxendale rule restricts promisor's liability, thus scope of damage is narrower than that for action in tort).

* See Smith, 72 B.R. at 301 (attorney's fees claim does not flow from tort of false pretenses); see also Stewart v. Sonneborn, 98 U.S. 187, 197 (1878) (attorney's fees are not
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provided for in the Note, and therefore, it follows that those fees were an element of damage foreseen by the parties.

II. EVALUATING THE AFTERMATH OF TranSouth

A. Precedent, Philosophy, and Policy

I. Precedent

The Eleventh Circuit was not the first circuit to consider attorney’s fees to a prevailing creditor as part of debt within the meaning of section 523(a)(2) of the Code. In Martin v. Bank of German-town, the Court of Appeals for the Sixth Circuit held that when foreseeable, therefore they are not proximately caused by actions of defendant); cf. Security Mortgage Co. v. Powers, 278 U.S. 149, 154 (1928) (“contract for attorney’s fees presents ... question of local law”). But see TranSouth, 931 F.2d at 1517 (Clark, J., dissenting) (rejecting applicability of Security Mortgage, and adding that court may not look to state law in determining what constitutes alimony in dischargeability proceedings) (citing Security Mortgage, 278 U.S. at 154)).

Interest on money fraudulently received by the debtor has generally been excepted from discharge pursuant to state law. See Southeast Nat’l Bank v. Jordan (In re Jordan), 927 F.2d 227, 227-28 (5th Cir. 1991) (nondischargeable debt included interest to which creditor was entitled under state law); Allen v. Romero (In re Romero), 535 F.2d 618, 623 (10th Cir. 1976) (same); First Interstate Bank of Wash., D.C., N.A. v. Hecker (In re Hecker), 95 B.R. 1, 3 (Bankr. D.D.C. 1989) (“[i]nterest is clearly part of the debt for money obtained by the Debtor’s false representation.”); Dodson v. Church (In re Church), 69 B.R. 425, 434-35 (Bankr. N.D. Tex. 1987) (money obtained by false representations included in nondischargeable debt); Builders Lumber & Supply Co., Inc. v. Fasulo (In re Fasulo), 25 B.R. 583, 586 (Bankr. D. Conn. 1982) (benefit of bargain rule justifies award of interest at contractual rate). But see Florida Nat’l Bank v. Gordon, 91 B.R. 135, 138 (Bankr. N.D. Fla. 1988) (no sums awarded in excess of principal, thereby precluding award of interest). Even though there was no express statutory authorization for an award of interest in TranSouth, the bankruptcy court looked to the Note and granted interest to the prevailing creditor. See Appellant’s Brief, supra note 11, at 13 n.4. This is the same Note pursuant to which the court refused to enforce the right to attorney’s fees. Id.; see also 3 COLE ON BANKRUPTCY ¶ 523.12 (15th ed. 1988) (no statutory award of interest expressed in Code).

See supra note 14 (describing attorney’s fees provision in Note).

46 See Redgrave v. Boston Symphony Orchestra, Inc., 602 F. Supp. 1189, 1212 (D. Mass. 1985) (Judge Keeton instructed jury that “[d]amages are allowed ... if the harm was a foreseeable consequence within the contemplation of the parties to the contract when it was made”); Commercial Factors of Salt Lake City v. Jensen (In re Jensen), 113 B.R. 51, 54 (Bankr. D. Utah 1990) (attorney’s fees provided for in contract are part of debt bargained for by parties); First American Nat’l Bank v. Crosslin (In re Crosslin), 14 B.R. 656, 657 (Bankr. M.D. Tenn. 1981) (prevailing creditor awarded fees as “benefit-of-the-bargain” recovery). But see Check Central of Oregon, Inc. v. Barr (In re Barr), 54 B.R. 922, 925 (D. Or. 1984) (debtor for attorney’s fees held dischargeable because it did not result from services obtained by debtor); The Record Co. v. Bummbusiness, Inc. (In re Record Co.), 8 B.R. 57, 60 (Bankr. S.D. Ind. 1980) (creditor’s damages limited to funds actually obtained by debtor due to false representation); supra note 4 (text of § 523(a)(2)).
a debt is deemed nondischargeable under section 523(a)(2), attorney's fees as provided for by an enforceable underlying contract become part of the primary debt and are also nondischargeable. The *Martin* court reasoned that the Code did not intend to deprive prevailing creditors from collecting contractual attorney's fees. It is submitted that *Martin* has the effect of a statutory provision which would state, "Unless otherwise provided by written agreement, the creditor has no statutory right to attorney's fees in section 523(a)(2) proceedings."

Additionally, while the dissent in *TranSouth* observed that the *Martin* court was the only circuit court which had ruled on the attorney's fees question, two months prior to *TranSouth*, the Fifth Circuit adjudicated this same issue in *Southeast National Bank v. Jordan*. *Jordan* adopted the *Martin* approach, and enforced a prevailing creditor's right to attorney's fees in a section 523(a)(2) proceeding. It is submitted that *TranSouth* is an especially significant development in this area, as it indicates a possible trend in the circuits and provides a foundation for future decisions examining this issue.

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50 *Id.* at 1168. The Martins materially misrepresented their financial condition to the bank, and the bank justifiably relied on those misrepresentations. *Id.* at 1167. The court held that these misrepresentations constituted fraud, and therefore, the Martin's debt was deemed nondischargeable. *Id.* In holding that the related attorney's fees were also nondischargeable, the court stated that "[the Code] excepts from discharge the whole of any debt incurred by use of a fraudulent financial statement, and such a debt includes state approved contractually required attorney's fees." *Id.* at 1168.

51 *Id.*

52 See *TranSouth*, 931 F.2d at 1517 n.40 (Clark, J., dissenting). However, this same issue was adjudicated by the Fifth Circuit just two months prior to *TranSouth*. See *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 227 (5th Cir. 1991) (nondischargeability of contractual attorney's fees in section 523(a)(2) proceeding).

53 927 F.2d 221 (5th Cir. 1991).


55 *TranSouth*, 931 F.2d 1505 (11th. Cir. 1991). *TranSouth* serves as a further guide for the Ninth Circuit, as several cases within the Ninth Circuit suggest that the *Martin* approach has been adopted. See *Silva*, 125 B.R. at 32 (court followed *Martin* and allowed prevailing creditor to collect attorney's fees in a section 523 nondischargeability proceed-
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2. Philosophy

The philosophy advocated by the Second, Seventh and Eighth Circuits provides that "the dischargeability of ancillary obligations such as attorney’s fees turn on the dischargeability of the underlying debt." Thus, it appears that these courts would allow creditors to collect attorney’s fees, irrespective of whether a contract exists, as long as the underlying debt which gave rise to those fees is also nondischargeable. However, because exceptions to discharge have been strictly construed, the creditor must overcome
a formidable burden in order to establish such an exception. It is submitted that an award of attorney's fees, conditioned on meeting such a burden, is a narrow remedy. Although this remedy is narrow, it is argued that it is inconsistent with the legislative intent to deny prevailing creditors a wholesale right to attorney's fees.

In contrast, the philosophy of TranSouth. is more moderate because it takes into account section 523(d)'s legislative history, which articulates a reluctance to provide prevailing creditors with a statutory right to attorney's fees. TranSouth requires a contractual right to attorney's fees and requires the creditor to prevail in a section 523(a)(2) adversary proceeding. This transforms an "award" into a "right," indicating strict adherence to the narrow contract exception carved out of the American Rule. Furthermore, TranSouth is limited to actions brought under section 523(a)(2), thereby preventing only the fraudulent debtor from obtaining a "fresh start." It is therefore suggested that TranSouth

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presents a standard which yields a more equitable result from the vantage points of both the creditor and the debtor.

3. Policy

It is also argued that the enforcement of contractual attorney's fees in *TranSouth* is consistent with the "fresh start" policy underlying the Code. Significantly, this policy is only intended to benefit the "honest but unfortunate debtor." Since enforcement of the attorney's fees provision in *TranSouth* is limited to actions brought under section 523(a)(2) (the debtor fraud exception to discharge), all nonprevailing debtors are deemed to have committed fraud. Therefore, it is only the fraudulent debtor who is denied a "fresh start" and required to pay attorney's fees. An honest debtor is not subject to the attorney's fees clause, and might even be entitled to reimbursement of his own attorney's fees under section 523(d).

It is submitted that the *TranSouth* decision is consistent with the Bankruptcy Code's policy of maintaining a uniform bankruptcy law. For example, the *TranSouth* court deferred to *Brown v. Felsen* and recognized the determination of dischargeability as a federal cause of action. In addition, it gave further support to the Sixth Circuit's holding in *Martin* by agreeing that a contractual attorney's fee provision, awarding such fees to a successful creditor in a bankruptcy nondischargeability proceeding, is enforceable.

Moreover, the *TranSouth* rationale promotes the Code's underlying policy that debtors and creditors be treated equally under both state and federal bankruptcy law in the absence of a legitimate bankruptcy policy to justify any disparate treatment.


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the court in *Southeast Bank v. Jordan* observed, a discharge of attorney's fees on a contractual debt otherwise nondischargeable would leave the dishonest debtor in a better position under federal bankruptcy law than under state law.\(^9\)

*TranSouth* might appear to be inconsistent with the Code's policy of protecting debtors' rights because it has the effect of reducing creditors' costs.\(^0\) However, the case should be examined in light of the great number of bankruptcies since the Code's enactment.\(^1\) Although Congress has indicated that the creditor is better able to bear the costs of litigation than a consumer debtor,\(^2\) it is contended that with this drastic rise in bankruptcy proceedings, creditors will pass these costs on to borrowers. The result would be a substantial increase in the cost of credit, which could in turn further depress the nationwide flow of capital.\(^3\)

\(^9\) Id. at 228.

\(^0\) See supra note 2 (an underlying policy of Code is to protect debtor).

\(^1\) See T. Sullivan et al., *Review: As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America*, 88 Mich. L. Rev. 1506, 1512 (1990). The following figures indicate the number of bankruptcy filings in recent years:

<table>
<thead>
<tr>
<th>Year</th>
<th>Filings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>477,586</td>
</tr>
<tr>
<td>1987</td>
<td>561,278</td>
</tr>
<tr>
<td>1988</td>
<td>594,567</td>
</tr>
<tr>
<td>1989</td>
<td>642,993</td>
</tr>
<tr>
<td>1990</td>
<td>880,000</td>
</tr>
<tr>
<td>1991</td>
<td>1,000,000</td>
</tr>
</tbody>
</table>


\(^3\) See *Legislative History*, supra note 5, at 6092. Congress stated that "the creditor is better able to bear the costs of litigation than a bankrupt debtor, and it is likely that a creditor's attorney's fees would be substantially higher than a debtor's, putting an additional disincentive on the debtor to litigate." *Id.* See generally Keeton et al., supra note 44, § 4, at 24 (tort concept of shifting loss to party best able to distribute it).

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B. Impact on Creditor and Debtor

Congress did not grant a statutory award of attorney's fees to prevailing creditors because it was wary of creditors who would use statutory authorization to induce consumer debtors to settle their claims prior to litigation. In reconciling this concern, the *TranSouth* majority noted that any settlement entered into between a creditor and a debtor would be subject to strict scrutiny by the court. Moreover, the existence of a prevailing creditor's right to contractual attorney's fees and a prevailing consumer debtor's right to such fees under section 523(d) generally results in an award of attorney's fees to the prevailing party. A recent study has shown that awarding attorney's fees to the prevailing party promotes litigation rather than settlement. Thus, it is con-
tended that the honest consumer debtor’s protection against forced settlements is preserved, and the creditor is barred from exercising undue leverage in obtaining a settlement.

CONCLUSION

It is a longstanding policy of the Bankruptcy Code to provide the honest debtor with a “fresh start”—a discharge of indebtedness. However, a fraudulent debtor should not be afforded the same protections as an honest debtor. When a bankruptcy court finds in favor of a creditor in a section 523(a)(2) adversary proceeding, concluding that the debt is nondischargeable, a fraudulent debtor should not be able to avoid paying the creditors attorney's fees by hiding behind Code protections. Rather, the debt, as defined by the terms of the contract and the Code should be enforced in its entirety.

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